ONTARIO

LEGISLATIVE ASSEMBLY

1971

REPORT ON CO-OPERATIVES BY SELECT COMMITTEE ON COMPANY LAW

TABLED IN THE LEGISLATIVE ASSEMBLY BY

THE HON. GORDON R. CARTON, Q.C.
CHAIRMAN

4th SESSION, 28th LEGISLATURE, 20 ELIZABETH II

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PROVINCE OF ONTARIO
LEGISLATIVE ASSEMBLY
SELECT COMMITTEE ON COMPANY LAW
REPORT
ON
CO-OPERATIVES

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TERMS OF REFERENCE

On Tuesday, July 23, 1968 in the Legislative Assembly of Ontario, the Honourable Mr. John P. Robarts (The Prime Minister) moved, and the Honourable C. S. MacNaughton (The Provincial Treasurer) seconded, a resolution, which read in part as follows:

> "That a select committee of this House be appointed to continue the enquiry and review of the law affecting the corporations in this province as reported on by the select committee of this House appointed on June 22, 1965, and re-appointed on July 8, 1966, and in particular, to enquire into and review the law relating to mergers or amalgamations, the rights of dissenting shareholders in the event of various fundamental corporate changes, the purpose, function and scope of the annual return, the field of corporation finance, the law relating to the protection of the creditor, and the dissolution of the ordinary commercial corporation in Ontario.
>
> And further, to enquire into and report upon such specialized types of corporations as insurance companies, loan and trust companies, corporations without share capital, credit unions, finance and acceptance companies, co-operatives, and extra-provincial companies, together with the legislation of other jurisdictions relating to the same matters . . .
>
> And the said committee to consist of 13 members to be composed as follows:
>
> Mr. Carton (Chairman), Messrs. Braithwaite, De Monte, Henderson, Johnston (St. Catharines), Lawrence (Carleton East), Meen, Price, Reilly, Renwick (Riverdale), Rowe, Shulman and Sopha.
>
> Motion agreed to."

On June 26, 1969, by order of the House, Mr. Trotter was substituted for Mr. Sopha in the membership of the Committee.

On January 21, 1970, Mr. Lawlor was substituted for Mr. Shulman in the membership of the Committee.

TO: The Honourable F. M. Cass, Q.C.,
Speaker of the Legislative Assembly of the Province of Ontario:

Sir:

We, the undersigned members of the Committee appointed by the Legislative Assembly of the Province of Ontario on July 23, 1968 to enquire into and review, inter alia, the law relating to co-operatives, together with legislation of other provinces relating thereto, have now the honour to submit the attached Report on co-operatives.

Gordon R. Carton	Leonard A. Braithwaite
Gordon R. Carton, Q.C., Chairman	Leonard A. Braithwaite, Q.C.
D. M. DeMonte	Lorne C. Henderson
Dante M. DeMonte, Q.C.	Lorne C. Henderson
R. M. Johnston	H. J. Price
Robert M. Johnston	H. J. Price
A. K. Meen	James Renwick
Arthur K. Meen, Q.C.	James Renwick, Q.C.
Leonard M. Reilly	Patrick D. Lawlor
Leonard M. Reilly	Patrick Lawlor, ~~Q.C.~~
Russell D. Rowe	James B. Trotter
Russell D. Rowe	James B. Trotter, Q.C.

INTRODUCTION

The Committee was reconstituted on July 23, 1968 with revised terms of reference, which appear above, covering a range of specialized corporations and certain aspects of the business corporation not reported on in the first Interim Report of the Select Committee. In view of the breadth of the terms of reference and in particular, the time involved in reviewing the law relating to the number and variety of specialized corporations included for consideration by this Committee, it was decided from the outset to examine and report upon each major topic separately.

Having reported on credit unions, the Committee proceeded to complete its consideration of the law relating to co-operative corporations by examining next co-operatives other than credit unions.

Submissions were invited from interested persons and a list of those received by the Committee appears at the end of this Report. Between January 21, 1970 and February 22, 1971, 31 meetings of the Committee were held. As in previous Reports, the Committee's concern was confined to the corporate legislation affecting co-operatives. The deliberations and recommendations of this Committee were therefore made without discussion of or reference to the incidence of taxation upon co-operatives or such changes as are contemplated in the White Paper on Taxation.

In this Report, the Committee has attempted to examine the co-operative principles embodying the social philosophy which has been the inspirational force behind the growth of the co-operative movement in many countries, and to evaluate their relevance and applicability to co-operatives in Ontario today. The Committee believes that the legislation can and should achieve a balance that would accord due recognition to the social precepts fundamental to co-operation and the exigencies of modern business efficiency necessary to enable a co-operative effectively to perform its economic function. The recommendations in this Report are collectively directed towards this aim. The resulting blend of business and social philosophy which is the essence of co-operation may differ in emphasis from that prevailing in other provinces but the Committee is of the view that, in Ontario at least, the co-operative partakes more of the nature of a standard business corporation operating according to particular methods than an institution in which the economic function is secondary to its social nature.

As was specifically provided for in its terms of reference, the Committee's study of co-operatives included an examination of the relevant

legislation of other provinces and the Committee wishes to record its gratitude to the provincial authorities and representatives of co-operative movements of the other provinces from whom valuable information was obtained.

Representatives of the Committee met a number of persons connected with government and the co-operative movement in Ontario and the members of the Committee wish to express their appreciation particularly to Mr. J. E. O'Meara, Associate Director of the Farm Economics, Co-operatives and Statistics Branch of the Ontario Department of Agriculture and Food and to Dr. R. S. Staples, formerly President of the Co-operative Union of Canada, for their expert advice and continuous assistance to the Committee. A position paper prepared for the Committee by Professor C. H. McNairn of the Faculty of Law, University of Toronto also greatly assisted the staff of this Committee in its research into co-operatives.

Although this Committee is indebted to a number of persons and organizations, only some of whom are noted above, this Report would not have been possible had it not been for the ability, experience and determined purpose of our Counsel, Mr. John W. Blain, Q.C. of the Toronto firm of McCarthy and McCarthy who has worked unceasingly in the preparation of this Report. Mr. Blain and our Research Director, Mr. Saul Schwartz were appointed to this Committee when it was reconstituted in 1968.

The members of the Committee and the staff wish to express their appreciation to Mrs. Frances I. Nokes who so ably, over the whole of the period of the Committee's existence, has performed our innumerable secretarial duties and the management of the Committee's office.

In the text of the Report The Ontario Corporations Act in most places appears as "The Act" and is cited in footnotes only by reference to the relevant section. The Business Corporations Act, 1970, S.O. 1970, c.25 is referred to throughout as "The Business Corporations Act". The legislation governing co-operatives in other provinces is cited by reference only to the province followed by the relevant section. In the case of Quebec and Saskatchewan, where more than one statute regulates co-operative associations, "The Quebec Act" refers to the Co-operative Associations Act, R.S.Q. 1964, c.29 and "The Saskatchewan Act" to The Co-operative Associations Act, R.S.S. 1965, c.246 while other legislation governing co-operatives in Quebec and Saskatchewan is cited in full.

The full citation of the principal legislation governing co-operatives in the provinces appears below.

ONTARIO

The Corporations Act, R.S.O. 1960, c.71 as amended, 1960-61, c.13; 1961-62, c.21; 1962-63, c.24; 1964, c.10; 1965, c.21; 1966, c.28; 1968, c.19; 1968-69, c.16; 1970, c.30.

ALBERTA

The Co-operative Associations Act, R.S.A. 1970, c.67.

BRITISH COLUMBIA

Co-operative Associations Act, R.S.B.C. 1955, c.77 as amended, 1963, c.10; 1964, c.13; 1965, c.50; 1968, c.53.

MANITOBA

The Companies Act, R.S.M. 1970, c.C160.

NEW BRUNSWICK

The Co-operative Associations Act, R.S.N.B. 1952, c.40 as amended, 1954, c.29; 1955, c.34; 1956, c.25; 1960, c.21; 1967, c.31; 1968, c.22; 1969, c.25; 1970, c.15.

NEWFOUNDLAND

The Co-operative Societies Act, R.S.N. 1952, c.172 as amended, 1954, c.42; 1963, c.4; 1966, c.23; 1966-67, c.79.

NOVA SCOTIA

Cooperative Associations Act, R.S.N.S. 1967, c.57 as amended, 1969, c.32.

PRINCE EDWARD ISLAND

The Co-operative Association Act, R.S.P.E.I. 1951, c.32 as amended, 1956, c.5; 1957, c.9; 1968, c.13; 1969, c.10.

QUEBEC

Cooperative Associations Act, R.S.Q. 1964, c.29 as amended, 1966-67, c.87; 1968, c.75.

Cooperative Agricultural Associations Act, R.S.Q. 1964, c.124 as amended, 1966-67, c.82.

Cooperative Syndicates Act, R.S.Q. 1964, c.294.

SASKATCHEWAN

The Co-operative Associations Act, R.S.S. 1965, c.246 as amended, 1966, c.28; 1967, c.50; 1969, c.91.

The Co-operative Marketing Associations Act, R.S.S. 1965, c.247 as amended, 1969, c.10.

The Co-operative Production Associations Act, 1967, R.S.S. 1967, c.53 as amended, 1969, c.11.

CHAPTER I

Nature and Definition of a Co-operative

1. In the absence of any precise, authoritative definition of a co-operative association,[1] the popular use of the word "co-operative" has been a prolific source of confusion. A co-operative association is a particular form of group venture organized and conducted in accordance with recognized precepts of co-operation based upon the Rules of the Rochdale Society of Equitable Pioneers, formulated in 1844. However, in the popular sense, the term co-operative is indiscriminately applied to describe any group of persons who act jointly or concurrently towards a common end and, although there is usually a connotation of a non-profit element, the means employed are not always regarded as significant.

2. Co-operatives may exist in the form of clubs or other unincorporated associations since their aims and methods rather than their legal status are of determinative significance but as this Committee is concerned primarily with incorporated co-operatives, references to co-operative associations in this Report will mean throughout co-operative corporations.

3. As an enterprise organized for the economic benefit of its members and administered by a board of directors, the function and organization of a co-operative bear certain resemblances to an ordinary business corporation with which it must usually compete successfully if it is to produce savings for its members on the goods and services which it is organized to supply. There are, however, a number of important differences stemming principally from the social philosophy of the aims of co-operation and the basic relationship between the co-operative and its members. The typical business corporation is an economic venture in which capital is invested for the purpose of realising a pecuniary gain. The shareholders comprise a group of investors who own, control and participate in the profits of the corporation in proportion to their capital investment and are distinct from the patrons from whose dealings with the corporation the profits are derived. In contrast with the speculative nature of a business corporation which exists to make a profit from patrons for the exclusive benefit of investors, the members of a co-operative consist of a group of patrons who voluntarily combine to provide themselves with mutually needed goods and services on a non-profit basis in response to a common economic need arising from dissatisfaction with the inadequacies or cost of existing facilities.

4. A co-operative is therefore essentially, but not exclusively,[2] a mutual association whose members comprise a group of users rather than investors. The investment of the member in the capital of a co-operative is made for the primary purpose of enabling the co-operative to supply the members

with mutually needed goods and services rather than for the entrepreneurial purpose of realising a profit on an investment. Reflecting these essential differences the co-operative method seeks to socialize the interests of the members by eliminating or minimizing the role of the member qua investor and maximizing the role of the member qua patron, restricting the return on invested capital to a nominal rate, requiring that the surplus of the co-operative be distributed to the members according to their patronage rather than their investment and by substituting for the capitalist principle of "one vote per share" the co-operative principle of "one vote per member" regardless of the number of shares. The social ideals of co-operation have been described as "economic democracy on the lines of liberty, equality and fraternity", which, translated into the co-operative precepts, govern the manner of its operation.[3]

5. The social philosophy of a co-operative, the limitations on voting rights and the de-emphasis on the role of investment capital are aspects which give a co-operative a certain resemblance to a non-profit corporation subject to Part III of the Act but, although it may be said that a co-operative is no more than a conduit or cost reducing agency for its members and therefore does not receive any income, it is nonetheless a method of business which may be carried on for the purpose of pecuniary gain for its members and does not therefore qualify as a Part III non-profit corporation.[4]

6. The distinctive attributes of a co-operative may best be understood in the context of the co-operative principles. Although the basic idea of co-operation and examples of co-operative ventures can be traced to several countries before the nineteenth century, the modern co-operative movement is generally regarded as originating in 1844 when the Rochdale principles were first formulated by the Rochdale Society of Equitable Pioneers in England. The 1840's in England, sometimes described as the "hungry forties", were a period when labour was cheap and abundant and the worst excesses of the Industrial Revolution had produced a poverty stricken working class exploited by employers who paid wages below subsistence level and shopkeepers who charged exorbitant prices for basic goods of poor quality and maintained their hold on their impoverished clientele by an usurious system of credit. The ultimate aim of the Rochdale Pioneers, like that of several other co-operative experiments which preceded it, was to relieve the plight of the working class by arranging the "powers of production, distribution, education and government . . . to establish a self-supporting home colony of united interests". The first objective was to establish a co-operative store to provide essential goods and services of dependable quality to the working class on terms which would include no profit to the Society. A co-operative grocery store was established at Toad Lane by 28 members of the Rochdale Pioneers, each of whom subscribed £1 in capital and from these small beginnings

grew the English co-operative movement which has provided a model for the co-operative movements in many other countries including Canada.[5]

7. As originally formulated in 1844, the Rochdale principles provided for:
    1. Open membership.
    2. Democratic control (one member, one vote).
    3. A fixed low rate of interest on capital.
    4. Distribution of surplus, after payment of interest and expenses, to members in proportion to their purchases.
    5. Cash trading.
    6. Selling only pure and unadulterated goods.
    7. Provision for education.
    8. Political and religious neutrality.
    9. Sale of goods at retail prices.[6]

Although these principles form the original ideological basis on which modern co-operatives are organized, it is perhaps important to consider several factors when evaluating their significance and general application to co-operatives in Ontario today.

8. Firstly, the Rochdale principles were apparently formulated upon the assumption that the co-operative movement was a movement for the exclusive benefit of the ultimate consumer, designed to eliminate all entrepreneurial profits by vesting in member consumers ultimate control over the manufacture and supply at all levels of goods and services they required for the satisfaction of their wants.[7] The English co-operative movement began as and has remained a predominantly consumer co-operative movement in which regional wholesale and manufacturing co-operatives are owned or controlled by the members of consumer retail co-operatives affiliated to the wholesale co-operative society on a federal or centralized basis. In contrast, the co-operative movement in Canada is composed principally of agricultural producer co-operatives, the primary aim of which is not to reduce the costs to the consumer but to increase returns to the producer, either by reducing the costs of production through the collective purchase of essential supplies on a co-operative basis or by reducing marketing costs by means of a marketing co-operative, in each case increasing the income to the patron producer by the savings resulting from supplanting the middleman. The distinction between consumer and producer co-operatives is important in view of the widely held assumption that the Rochdale principles apply with equal validity to both producer and consumer co-operatives. The Rochdale principles were intended to apply only to consumer owned co-operatives and certain principles such as that of open membership are, therefore, of doubtful application to producer co-operatives.

9. Secondly, with the abandonment of the utopian idea of a self-supporting home colony and changes in the economic and social community, it became

apparent that certain Rochdale principles were no longer wholly valid in their original form. Accordingly, there have been two attempts by the International Co-operative Alliance, one in 1937 and the other in 1966, to reformulate the Rochdale principles, the texts of which are reproduced in appendix A of this Report. These efforts to revise the Rochdale principles resulted in restatements in broader language and of a higher degree of abstraction in order to accommodate and encompass modifications made necessary by the growing variety of co-operatives with particular features and changes in methods to meet local conditions in different countries. It would, therefore, appear that there exists no universally applicable immutable set of co-operative principles.

10. A third factor affecting any evaluation of co-operative principles is the professionalization of management which has accompanied the growth of the co-operative movement. Co-operation is a mixture of business and social philosophy with the emphasis increasingly on business and in recent years there have been a number of statements to the effect that ideology must not be insisted upon at the expense of efficiency.[8] Nevertheless, despite certain difficulties in reconciling commercial efficiency with co-operative principles, the social ideology of the co-operative as a voluntary group of individuals, motivated by common need rather than speculative profit, combining to aid each other through organized self-help still permeates its economic purpose.

11. The co-operative association may thus imperfectly be defined as a voluntary association of persons organized for the purpose of supplying themselves with mutually needed goods and services by means of a collective enterprise owned by and operated for the benefit of the members according to the accepted aims and methods of co-operation from time to time prevailing.

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1. So far as can be ascertained there exists no reliable definition of a co-operative. *The Report of the Royal Commission on Co-operatives* (1945), which is perhaps the most exhaustive analysis of the co-operative movement in Canada, did not attempt to define a co-operative. The standard legal text on Canadian co-operatives begins:

   > "What is a co-operative?
   >
   > As an economic institution it requires one definition; as a legal body it requires another. Both definitions require to be supplemented by a statement of characteristics and attributes."
   >
   > W. B. Francis, *Canadian Co-operative Law* (1959), p. 1.

   The absence of any recognized definition is not confined to Canada for it appears that neither the English legislation or jurisprudence defines a co-operative. According to one standard legal text on co-operatives in the United States,

   > "A cooperative can be defined for practical purposes as a democratic association of persons organized to furnish themselves an economic service under a plan that eliminates entrepreneur profit and that provides for substantial equality in ownership and control."
   >
   > I. Packel, *The Organization and Operation of Cooperatives*, (3rd, ed. 1956) p. 2.

This definition has received judicial approval in the United States but, in the most recent edition of his text (4th ed. 1970, p.3), the author has added,

> "This definition is of value as a matter of clarification, but should not be used as an absolute to make exclusions or limit analysis. Mr. Justice Brandeis long ago pointed out that no one plan of organization is to be labeled as truly cooperative to the exclusion of others."

2. Unlike a credit union, a co-operative may deal with non members, subject to certain limitations referred to in Chapter 7, *infra.*
3. Brandeis, J. in *Frost v. Corporation Comm'n.*, 279 U.S. 515 at 537 (1928) (dissenting).
4. See Ontario Corporations Manual Vol. II, p. 7503.
5. See further, G. D. H. Cole, *A Century of Co-operation* (1944); G. J. Holyoake, *History of the Rochdale Pioneers* (1907).
6. The precise number, formulation and order of presentation of the original Rochdale principles have been the subject of some controversy. Although nine such principles are listed in the text there is evidence that there were perhaps only eight original principles, "Sale of goods at retail prices" being added at a later date. According to the International Co-operative Alliance there were only seven original principles to which "Sale of goods at retail prices" and "Selling only pure and unadulterated goods" do not belong. See further Appendix A, *infra.*; H. H. Bakken, Principles and their Role in Statutes Relating to Cooperatives, *1954 Wisconsin Law Rev*, p. 551
7. See P. H. Casselman, *The Cooperative Movement* (1951), pp. 14, 125. See A. Bonner, "The Consumers Co-operative Movement", in *Agricultural Producers and Their Markets*, (ed. Warley 1969), p. 371.
8. See Lord Taylor of Gryfe, President of Scottish Co-operative Wholesale Society, "Co-operatives in a changing world", *Canadian Co-operative Digest*, vol. 12, No. 1, p. 27. (1970). E. G. Nourse; "From Dogma to Science in Cooperative Thinking" in *Agricultural Cooperation* (1946), p. 6; *Co-operative Independent Commission Report*, Co-operative Union (1958), pp. 236-237.

CHAPTER 2

History and Development

1. An examination of the history and development of co-operation in Canada suggests that the ideas and examples of the co-operative movement in one province spread and influenced the development of the co-operative movement in other provinces.[1] It also indicates the impracticability of attempting to trace chronologically the growth of the co-operative movement in Canada since in the absence of suitable legislation for their incorporation, co-operatives in various parts of Canada were for many years organized on an informal basis and it is difficult almost a century later to differentiate between unincorporated co-operatives and other contemporary associations which, although mutual in nature, did not conform to the basic precepts of co-operation and should therefore not be classified as co-operatives.

2. Although isolated examples of co-operatives can be traced to the nineteenth century, the establishment of a co-operative movement in Ontario occurred somewhat later than in many provinces.[2] This was probably due to a number of factors including the close ties between the attempts of farmers to improve their economic conditions and their political ambitions which came to fruition only in 1919, the lack of government financial assistance as in the Prairies and the Maritimes, a general lack of understanding of the principles of co-operation, and the enactment only in 1917 of legislation suitable for the incorporation of co-operative associations. The main form of economic association among farmers was the "buying club" which was an informal unincorporated association organized for the purpose of eliminating middleman's profits by pooling purchases of such essential farm supplies as salt and binder twine. Several hundred of such independent buying clubs were in existence by 1914, but because of their informal nature they were often of limited duration.

3. Until 1914 the agricultural movement in Ontario was relatively weak and fragmented. Organizations for the political and economic joint action of farmers were formed as early as 1870 and proliferated after 1880 but were generally short lived and of little influence.[3] The establishment in 1914 of two farmers' organizations, United Farmers of Ontario [UFO], a political and educational association, and United Farmers Co-operative Company Limited [UFC], which was intended to act as a wholesale supply central for the numerous farmers buying clubs, the few existing local farm supply co-operatives and any other local organizations affiliated to UFO, resulted in the consolidation of the agricultural movement in Ontario. Many local farmers' associations merged with UFO and hundreds of UFO clubs were formed throughout the province. Thus united, the agricultural com-

munity was a receptive forum for the campaign of UFO to encourage farmers to combine against what were viewed as monopolistic forces controlling the marketing of their produce. The enactment in 1917 of special legislation for co-operatives, the propagation of co-operative philosophy by co-operators from the United States and the example of the Prairies were also factors which spurred collective action by farmers through the formation of co-operatives.

4. In 1919, the political ambitions of the Ontario farmers were realized when the representatives of the UFO Party formed the provincial government. But the political success of UFO was brief and its influence did not extend beyond its defeat at the polls in 1923, although the organization continued in existence until 1944. UFC also suffered reverses at this time due to managerial, structural and financial problems experienced from over-expansion of its wholesale services, unprofitable ventures into retail branch operations and the dilution of its membership by the admission of individuals, but its separation from UFO and the success of its basic farm supplies service and dairy processing division contributed to its continued stability between 1925 and 1935. By the mid-1920's the framework of a co-operative movement in Ontario based upon specialized fruit and vegetable marketing co-operatives in Southern Ontario, the dairy and poultry marketing division of UFC and a number of independent farm supply co-operatives had been established which survived the depression of the 1930's. The recovery of the economy and a new generation of farmers led to a revival of interest in co-operatives at which time UFC was reorganized to offer a more limited range of services to affiliated member locals.

5. The outbreak of World War II and the return to full production gave a renewed impetus to the co-operative movement in Ontario resulting in the formation of a number of new farm supply co-operatives designed to minimize the effect of wartime restrictions on agricultural supplies. The number and variety of local co-operatives continued to increase and flourish in the early years after the war. In 1948 UFC was replaced by United Co-operatives of Ontario [UCO].

6. Since the mid-1950's the number of agricultural co-operatives in Ontario has steadily declined although the volume of business and number of members served by co-operatives has continued to increase. Many farm supply co-operatives beset by problems of member apathy, increased competition, difficulties in raising finance to modernize their facilities and in attracting competent management, experienced financial difficulties and either ceased to operate or have merged with UCO and continued as retail branch outlets of that organization. The post-war establishment of producer marketing boards with statutory powers to regulate the price payable to producers of some thirty products have superseded marketing co-operatives as a vehicle for ensuring a fair return to the producer. More recently,

a number of dairy processing co-operatives and milk transportation co-operatives have been adversely affected by regulations of the Ontario Milk Marketing Board and as a result the future of several such co-operatives is in doubt.

7. According to a Survey carried out by the Ontario Department of Agriculture and Food[4] there were, in 1966, some 234 co-operatives, excluding medical co-operatives, incorporated and operating in Ontario with a total annual volume of business exceeding $228,000,000 which rank the co-operative movement in Ontario fourth among the provinces after Saskatchewan, Alberta and Quebec respectively. As defined by the Survey, the local co-operatives include:

64 marketing co-operatives, with total sales volume of	$109,934,817
110 distribution co-operatives, with total sales volume of	102,747,756
60 service co-operatives, with total sales volume of	5,743,298
	$228,425,871

While the co-operative movement in Ontario is predominantly agricultural, it is not exclusively so and includes, to quote the Survey,

> "a brokerage agency for the purchase of ecclesiastical supplies for the Roman Catholic Archdiocese of Toronto, a slaughter service for stockmen at the Lakehead, a nursery school for the working mothers of Willowdale, a scale service for the weight conscious farmers of Lucknow, a taxi cab service for the footsore Torontonians and a funeral home for the deceased of Sudbury."[5].

To this should be added the growing number of direct charge co-operatives which have made their appearance since 1966.

8. In comparison with certain provinces there is, however, comparatively little co-operative housing in Ontario[6] and the use of the co-operative corporation as a means of assisting the economic development of the Indian population has, hitherto, not been sufficiently explored[7].

9. At the time of the Survey there were 34 local medical service co-operatives federated with the Co-operative Medical Services Federation. Although incorporated as co-operative corporations subject to Part V of the Act, medical service co-operatives are regulated by The Prepaid Hospital and Medical Services Act[8] and are, therefore, under the jurisdiction of the Superintendent of Insurance. The introduction of a provincial hospital services plan in 1959 limited medical co-operatives to the provision of services not available under the government scheme. The recent extension

of the medicare program to Ontario has led to a severe contraction in the possible services medical co-operatives are able to offer and has resulted in their centralization in the Co-operative Medical Services Federation, the principal function of which is presently to act as a premium collecting agency for OHSIP.

10. There are presently two regional co-operatives in Ontario. The Ontario Co-operative Credit Society, to which some 126 co-operatives are affiliated, acts as a major source of short term credit for co-operatives as well as for credit unions. United Co-operatives of Ontario, with some 30,000 incorporated and individual members, is the largest co-operative in Ontario. The range of its activities and the significance of its role in the co-operative movement in Ontario are examined in Chapter 21.

11. About 150 co-operatives or over three quarters of the total number of co-operatives in Ontario belong to the Ontario Co-operative Development Association [OCDA]. Founded in 1946 as the Co-operative Union of Ontario, OCDA is concerned principally with such matters as education, publicity, the provision of assistance in the incorporation of new co-operatives and representation of the co-operative movement in Ontario. OCDA is financed through a flexible dues system based on the volume of business of the member co-operative and is a member of the Co-operative Union of Canada, the national representative body of the co-operative movement which is affiliated to the International Co-operative Alliance. OCDA also maintains links with co-operatives in the United States through its membership in the American Institute of Co-operation.

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1. For a general survey of the historical development of co-operatives in Canada see M. Digby, *Agricultural Co-operation in the Commonwealth*, (1970).
2. The first cheese processing factory operated on a mutual basis for the benefit of participating farmers was formed as early as 1864 and a number of farmer owned cheese factories organized as co-operatives were incorporated as joint stock companies under the Act of 1865. Cost sharing schemes for shipping livestock were also established during the last quarter of the nineteenth century, and egg circles and co-operatively owned creameries developed after the turn of the century, but the extent to which these were operated as co-operatives in the Rochdale sense is dubious. See generally, J. E. O'Meara, *Ontario's Co-operatives 1946-47*, Ontario Department of Agriculture and Food (1948), p. 64; B. B. Perkins, *Co-operatives in Ontario* (1960), p. 54.
3. In the 1880's the Central Farmers Institutes provided a forum for farmers at annual conferences but the principal organization at that time was the Grange, an offshoot of a United States farmer's association which received a federal charter in 1877. At its peak the Grange had 26,000 members in Ontario and organized a number of mutual enterprises, the best known of which was the Ontario Peoples Salt Manufacturing Company which lasted thirty-eight years, but few of its ventures, which included dairy processing, fire insurance and banking, remained by 1900. During the 1890's, the Patrons of Industry spread into Ontario from Michigan and until 1900 was an active economic and political association. A number of farmer-owned joint stock companies were organized for the collective supply of binder twine and salt but without any long term success. The Farmers Association was established in 1900 by former leaders of the Patrons of Industry and eventually merged with the remnants of the Grange movement in 1907. See

generally, Perkins, *op cit. supra*, note 2 pp. 17-20; *Co-operatives in Canada*, Department of Agriculture (1968), p. 6.

4. J. E. O'Meara, *Ontario's Co-operatives 1966-67*, Ontario Department of Agriculture and Food (1968).
5. O'Meara, *op. cit. supra*, note 4, pp. 8-9.
6. A large proportion of the relatively little co-operative housing which exists in Canada is concentrated in the Maritimes and resulted from the success in that area of the Antigonish movement. Some co-operative housing exists in Ontario most of which has hitherto consisted of building co-operatives in which the co-operative effort is limited to the construction of housing which is then sold to individuals, rather than continuing co-operatives which are maintained as co-operatives after construction. Most continuing co-operatives in Ontario are organized among students or ethnic groups. Recently, there have been signs of increased interest in the co-operative method of housing evidenced by the completion of "Solidarity Towers" in Windsor, Ontario, a project financed by the United Auto Workers. It has been suggested that the paucity of co-operative housing in Ontario and in Canada in general is due principally to lack of capital and the inexperience of the co-operative movement in this field. Another factor may lie in the apparent preference of Canadians for individual ownership of their homes as is evidenced by the growth in recent years of condominiums. See J. P. Midmore, *Report on Co-operative Housing*, Co-operative Union of Canada (1962).
7. There are presently no co-operatives serving Indian communities in Ontario.

   In Alberta there are about 46 Indian and Metis co-operatives (the largest number of any province). The staff of the Registrar of Co-operatives has included for the past five years a Co-operative Development Office consisting of 5 persons exclusively responsible for assisting Indian and Metis co-operatives.

   In Manitoba there are presently some 23 Indian and Metis co-operatives operating principally in the areas of fishing, logging and related supplies. As in Alberta, the Registrar of Co-operatives maintains a special staff responsible for Indian and Metis co-operatives.

   In Saskatchewan where there are some 42 Indian and Metis fishing, power, merchandising and handicraft co-operatives, the Co-operative Services Extension Branch, which is formally responsible for supervising all co-operatives, has in recent years devoted much of its activities to Indian and Metis co-operatives. *Second National Statistical Report on Co-operatives Among Indian People in Canada, 1968*. Dept. of Indian Affairs and Northern Development.
8. R.S.O. 1960, c.304.

CHAPTER 3

History of Legislation

1. The history of legislation governing co-operatives in Ontario falls into three separate phases, distinct in the applicable legislation and in the underlying legislative philosophy. Between Confederation and 1907, co-operatives in Ontario were regulated by a separate self-contained statute enacted in 1865.[1] This Act was carried forward in Ontario legislation and first appeared, with certain amendments, in the Revised Statutes of 1877, as "An Act Respecting Co-operative Associations".[2] Under that Act it would appear that the co-operative was viewed as a quasi-public institution, governed by trustees rather than directors and regulated by rules rather than by-laws.

2. Despite its title, there was little, if anything, which either required or facilitated a corporation incorporated under the Act to possess the usual characteristics of a co-operative or to carry on business on what is generally viewed as a co-operative basis. Apart from the title, the only mention of the word "co-operative" is in a side note to the section which stated that "seven or more persons may associate themselves together for any labour, trader or business"[3] without specifying that the type of association must be a co-operative.

3. The only co-operative principles embodied in the Act were the limitation of one vote per member[4] and the requirement that all business be conducted on a cash basis.[5] One of the matters required to be dealt with by the rules was the mode of application of profits, although there was no requirement that they be distributed according to patronage. Until 1884 there was, perhaps, one possible safeguard that an association would operate as a true co-operative in the requirement that all rules receive the prior approval of the Lieutenant Governor.[6]

4. Another significant feature of the Act was the fact that incorporation was a matter of right accomplished by the filing of certain documents with the designated authority rather than by discretionary grant of letters patent which was then the normal method of incorporating an ordinary corporation. It appears that a co-operative was intended to be but one of the possible types of associations governed by the Act and that the word co-operative in the side note was used in a social sense rather than as an exact legal term.[7]

5. The second period began in 1907 when, for reasons which must remain a matter for conjecture, the Act Respecting Co-operative Associations was repealed.[8] Between 1907 and 1917, co-operatives were equated in every respect with ordinary business corporations since they were subject to The Companies Act, 1907, which contained no special provisions for

co-operative corporations. During this time it was only possible to incorporate a co-operative by special Act or as a joint stock company with the co-operative attributes consisting of special provisions inserted in the charter or by-laws. It is not known how many co-operative corporations were incorporated between 1907 and 1917, but it is understood that this period coincided with a renewed interest and greater appreciation of the co-operative method of doing business and perhaps because of the absence of suitable legislation, the majority of mutual associations which appeared during this time were organized as unincorporated associations.[9]

6. Since 1917, when the third and continuing phase of co-operative legislation began, co-operative corporations have been regarded in essence as business corporations governed by the general corporations statute. But the special features of co-operatives were also recognized by the enactment in 1917 of a special Part (Part XIA)[10] to the general corporations statute which contained provisions applicable exclusively to co-operative corporations. This framework still exists with Part V of the Act containing the special provisions applicable to co-operatives.[11]

7. Part XIA applied only to corporations "operated on a co-operative basis"[12] and a corporation was "deemed to be operating on a co-operative basis"[13] if provision was made in its charter or by-laws to restrict voting to one vote per member, with no proxies permitted, to limit return on capital and to require that any remaining surplus (after a discretionary provision for reserves) be distributed to the members according to patronage. Co-operatives were required to file copies of by-laws and amendments thereto with the Provincial Secretary and no by-law was valid until it was so filed.[14] Copies of financial statements and the auditor's report were also required to be filed with the Provincial Secretary,[15] who was empowered to inquire into the affairs of the co-operative or take other measures upon the application of at least 10 members.[16]

8. Part XIA, which appeared as Part XII in later consolidations, remained largely unchanged from 1917 to 1949 when a major revision of the co-operative Part was undertaken. A number of defects had become apparent, the most important of which was the absence of a provision relieving co-operatives with share capital from the common law prohibition upon the purchase by a corporation of its own shares, a provision essential to any scheme for raising finance from members by the retention and capitalization of patronage returns to be refunded in later years on a revolving basis. Co-operatives without share capital, financed by member loans, and therefore unaffected by any prohibition on the repurchase of shares, were able to operate a revolving loan scheme, and perhaps for this reason more than any other the large majority of co-operatives incorporated between 1917 and 1949 were organized without share capital despite the disadvantages that member loans were debt obligations carrying a pre-

determined fixed rate of interest in contrast with shares as risk capital and carrying only such dividends as might be declared in any year. Another defect particularly relevant to co-operatives with a large scattered membership was the absence of any power to institute a system of delegate voting.

9. In the revisions made in 1949:[17]

(i) co-operatives with share capital were given the right to purchase their common shares, subject to certain restrictions which are examined more fully in Chapter 16,

(ii) the revolving fund method of financing was given statutory recognition by permitting co-operatives to enact by-laws requiring shareholders or members to apply all or a part of their patronage return to the purchase of shares or as a compulsory loan to the co-operative,

(iii) co-operatives were empowered to enact by-laws establishing a delegate system of voting,

(iv) the right of the Provincial Secretary to intervene into the affairs of a co-operative upon the application of a specified percentage or number of members was deleted,

(v) the prefatory list of requirements in Part XIA for a corporation to be "deemed to be operating on a co-operative basis" was removed, and these special characteristics of co-operatives were incorporated in the substantive provisions of the legislation,

(iv) the Lieutenant Governor in Council was empowered to declare a co-operative no longer subject to the co-operative Part of the Act if it appeared that 50% or more of its business was transacted with non members.

As in previous Acts, the co-operative Part contained all the special provisions applicable to co-operative corporations whether organized with or without share capital which were supplemented by the general provisions of The Companies Act which applied unless expressly excluded or inconsistent.

10. This format was changed so far as co-operatives without share capital were concerned by the enactment in 1953 of Part III of The Corporations Act which contained the special provisions governing all corporations without share capital.[18] As "corporations without share capital",[19] co-operatives organized without share capital were subject in principle to the particular provisions of Part III. As "co-operatives without share capital",[20] they were expressly made subject to certain provisions in Part III exclusively applicable to co-operatives without share capital and expressly excluded from others designed only to affect non profit corporations. As

"co-operative corporations",[21] they were in addition subject to the provisions of Part V and by virtue thereof to all other provisions of the Act not excluded or inconsistent.

11. Since 1953 there have been only two amendments to the co-operative Part one of which amended the provisions relating to delegate voting[22] and the other removed the 6% interest ceiling on loans from members.[23] However, certain amendments to the general sections of the Act, which are considered below, also apply to co-operatives.

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1. An Act to authorize the formation of companies or co-operative associations for the purpose of carrying on, in common, any trade or business. S.C. 28-29 Vict., C. XXII. (1865).
2. R.S.O. 1877, c.158.
3. *Ibid.*, Sidenote to s. 1.
4. *Ibid.*, s. 11.
5. *Ibid.*, s. 15.
6. *Ibid.*, s. (2) repealed by S.O. 1884, c.27, s. 2.
7. Between 1900 and 1907 there existed a special statute for the incorporation and regulation of agricultural co-operative cold storage associations. The Co-operative Cold Storage Associations Act, S.O. 1900, c.26, was similar to the general Act of 1865 with the significant difference that each share carried one vote. The operative provisions of The Co-operative Cold Storage Associations Act were repealed by the Companies Act, 1907, c.34, Schedule E.
8. See The Companies Act, *supra*, note 7, Schedule E. It is perhaps pertinent to note that at this time serious efforts were being made to obtain passage of Federal legislation to regulate co-operatives, the Bill being defeated in the Senate by one vote. Federal legislation was not enacted until 1970 when the Canada Co-operative Associations Act, S.C. 1970, c.17 was enacted.
9. See Chapter 2, *supra*.
10. S.O. 1917, c.38, ss. 152*a-s*.
11. R.S.O. 1960, c.71, ss. 123-141.
12. S.O. 1917, c.38, s.152*a*.
13. *Ibid.*, s. 152a.
14. *Ibid.*, s. 152a(*a*).
15. *Ibid.*, s.152*p*(*c*).
16. *Ibid.*, s.152*r*, later amended to 10 members or one third of the total membership. S.O. 1920, c.53, s.3.
17. S.O. 1949, c.14.
18. S.O. 1953, c.19.
19. *Ibid.*, s.116(1).
20. *Ibid.*, s.116(2).
21. *Ibid.*, s.123.
22. In 1957, s.135 of Part V was amended to permit a co-operative to provide by by-law for the election of some or all of its directors by groups of members or delegates of such groups (S.O. 1957, c.15, s.2) and to provide that a co-operative which has initiated a system of electing its directors by delegates need only send a copy of the financial statement and annual report to the delegates, and not to each member unless he so requests. (S.O. 1957, c.15, s.3.)
23. S.O. 1968, c.18, s.11.

CHAPTER 4

Separate Act

1. Unlike every other province except Manitoba,[1] there is no separate Co-operative Associations Act in Ontario and the legislation governing co-operatives is contained in the general corporations statute.

2. Part V of the Act, which applies exclusively to all co-operative corporations, contains the particular provisions distinguishing co-operatives from other corporations. The 19 sections of Part V are supplemented by other provisions of the Act which are made applicable to co-operative corporations by reason of section 124(2) of Part V which provides:

> "(2) Except where inconsistent with the provisions of this Part, the other provisions of this Act apply to a corporation to which this Part applies.".

Co-operatives without share capital are in addition subject to some sections of Part III of the Act, which contains the particular provisions generally applicable to corporations without share capital. Under section 116(1)[2] certain general sections of the Act are made specifically applicable to all corporations without share capital, including therefore co-operatives without share capital, while other general sections of the Act listed in s.116(2)[3] apply exclusively to co-operatives without share capital. In view of the specific provisions of section 116, there may be some doubt concerning the scope of the application of section 124(2) to co-operatives without share capital.

3. Thus in order to ascertain the full extent of the law regulating co-operatives with share capital, reference must be made to Part V and such other provisions of the Act as are not inconsistent therewith while in the case of co-operatives without share capital, reference must be made to Parts III and V of the Act, certain general sections of the Act which under Part III specifically apply to all corporations without share capital and perhaps finally to all other provisions of the Act not inconsistent therewith which, under section 124(2), are stated to be applicable to all co-operative corporations.

4. The present system of regulating co-operative corporations by means of inserting separate provisions in the general Corporations Act has certain merits. Co-operative corporations are, in the view of the Committee, basically ordinary corporations with certain special characteristics and it is therefore appropriate that they should be subject to many of the general provisions governing ordinary corporations. The inclusion in the general Act of particular sections applicable only to co-operatives avoids needless duplication which would result under a separate Act relating to co-opera-

tives. However, the Committee considers that such possible advantages are outweighed by the complexities and uncertainties arising under the present legislative format from insufficient integration of the particular co-operative provisions with the general sections of the Act and inconsistencies between the particular provisions affecting co-operatives with and without share capital respectively. All co-operatives should be subject to identical regulations excepting those provisions exclusively concerned with the capital structure, but the drafting of the separate Parts has resulted in a number of unintended differences between co-operatives with and without share capital.

5. These defects are well illustrated in the FAME Report[4] where the question was raised whether a co-operative with share capital possesses the ancillary power contained in section 22(1) (e) to acquire and hold shares in other companies, since by the exercise of that power a co-operative might gain control of a non co-operative company and operate it on an ordinary commercial basis. The whole of the Act applies to corporations subject to Part V including, it would seem at first sight, section 22(1)(e) which provides:

> "22.(1) A company possesses, as incidental and ancillary to the objects set out in the letters patent or supplementary letters patent, power,
>
> (e) to take or otherwise acquire and hold shares in any other company having objects altogether or in part similar to those of the company or carrying on any business capable of being conducted so as to benefit the company;".

Mr. Justice Grant in the FAME Report expressed doubts as to whether section 22(1)(e) was consistent with the nature of co-operatives and whether it was therefore applicable[5]. Section 116(2) expressly provides that the whole of section 22(1) is applicable to co-operatives without share capital and precludes any question of inconsistency between section 22(1)(e) and the nature of a co-operative subject to Part V. If co-operatives without share capital are expressly empowered to acquire the control of a non co-operative company, it would be unreasonable to deny a similar power to co-operatives with share capital. If it is consistent with the nature of a co-operative without share capital to acquire and control an ordinary company and to operate it on a commercial basis it should not be inconsistent for a co-operative with share capital to do likewise.

6. Whether a co-operative should have such power is a separate question of principle involving further considerations examined in Chapter 20. What is relevant at this stage is that a co-operative without share capital clearly has such a power by reason of express provision in Part III while

there is no corresponding provision in Part V for a co-operative with share capital.

7. A number of other inconsistencies between the particular provisions affecting co-operatives with share capital and those without share capital attributable to drafting errors rather than the conscious intention of the legislature are noted in other Chapters, but in order to demonstrate further the disadvantages of treating co-operatives as corporations or companies under the Act, it might be useful at this stage to list some of the major discrepancies.

(a) It would seem that the profit and loss statements of co-operatives without share capital need not show sales or gross operating revenue, whereas this is required in the case of co-operatives with share capital. Co-operatives with share capital are subject to section 84(1)(a) which is not inconsistent with the provisions of Part V and is therefore applicable by reason of section 124(2). It is generally believed that co-operatives without share capital are not subject to section 84(1)(a) which for no apparent reason is specifically excluded by section 116(2) of Part III which in turn lists certain sections in Part II of the Act specifically applicable to co-operatives without share capital.

(b) A co-operative without share capital is not subject to any ceiling on the interest payable on member loans[6] whereas co-operatives with share capital are subject to a maximum dividend limit of 8% per annum.[7] A possible reason for this inconsistency and the desirability of retaining a dividend limit or imposing a ceiling on interest are examined in Chapter 14.

(c) Co-operatives without share capital would appear to have greater flexibility in regulating their terms of membership. Under section 112(1), which appears to be applicable to co-operatives without share capital, the directors may pass by-laws, not contrary to the Act or to the letters patent or supplementary letters patent, to regulate, among other things, "suspension and termination of membership by the corporation and by the member". This would appear to give a co-operative without share capital the right, by by-law, to provide for the expulsion of a member. There is no similar provision applicable to a co-operative with share capital.

(d) A co-operative with share capital may only purchase shares held by its shareholders subject to the restrictions contained in section 135(2). These restrictions, with the possible exception of the prohibition based on insolvency, do not apply to co-operatives without share capital with respect to the repayment of a member's investment.

(e) On the winding up of a co-operative without share capital, member loans and patronage returns that are loaned to the corporation rank after the ordinary debts.[8] There is no equivalent provision governing the priority of creditors on the winding up of a co-operative with share capital and it would therefore appear that patronage returns lent by a member of a co-operative with share capital could rank before the ordinary debts, depending upon the terms and conditions of the loan.

8. There are several generally applicable sections of the Act which, although not inconsistent with anything in Parts III or V, seem to be inappropriate to co-operative corporations because of the manner in which these corporations operate. One example is to be found in section 70 of the Act which requires a director to declare his interest in contracts with the company at a meeting of the board of directors or to the company in general meeting. In co-operatives, directors are normally, and perhaps should always be, active patrons of the organization and if the business consists of marketing it is on occasion anticipated that all members, including directors, will enter into a standard form of marketing contract with the co-operative. Disclosure by a director of a co-operative of all types of contractual interest is nevertheless required under the Act with the possibility of a director incurring certain liabilities for failure to comply with section 70. A related objectionable feature of the present legislative format is that amendments to the general sections of the Act are sometimes enacted with insufficient consideration of the effect of such amendments on co-operatives. This is perhaps less likely to occur since the enactment of The Business Corporations Act which, while affecting all business corporations, does not apply to co-operatives. This type of defect is exemplified by section 71 of the Act, enacted in 1967, which requires insiders as defined by s.71(1)(e) to file with the Ontario Securities Commission reports of their holdings and dealings in the securities of the company concerned. It might be questioned whether there is any necessity for compelling an insider of a co-operative with share capital to disclose regularly the extent of his ownership and dealings in the securities of a co-operative since he can have no more than a single vote regardless of his shareholdings, dividend returns are restricted and there is only a limited possibility of realizing a profit from the sale or redemption of those shares or on the dissolution of the co-operative.

9. In all provinces except Manitoba and Ontario, there are separate Acts governing the incorporation and regulation of co-operatives, which form more or less complete codes of the legislation affecting co-operative corporations.[9]

10. In Nova Scotia the provisions of the general corporations Act are specifically declared to be inapplicable to co-operative corporations.[10] In

other provinces, the respective Companies Acts are applicable in varying degrees but because of the comprehensive nature of the co-operative Acts, difficulties such as are extant in Ontario do not appear to arise. In Manitoba, which is the only other province where co-operatives are organized and regulated exclusively by the general corporations Act, the relevant Part[11] containing the particular co-operative provisions is more comprehensive than either Part III or Part V of the Act and authoritative assistance concerning the legislation is available to co-operatives from the office of the Registrar. Another important distinction, which would appear to be based on administrative practice rather than founded on statutory provision, is that it is not possible in Manitoba to incorporate a co-operative without share capital. This avoids some difficulties of cross references that exist in Ontario as well as the possibility of unintentional drafting inconsistencies between the particular provisions governing co-operatives with and without share capital. A third significant difference in Manitoba is a provision permitting the by-laws of a co-operative to depart from and to prevail over the provisions of Part II of the Manitoba Companies Act[12] which helps to determine the extent to which ordinary company law is and should be applicable to co-operatives. The Registrar of Co-operatives through the statutory requirement of his approval of all by-laws retains ultimate control over permitted deviations from the provisions of the Companies Act.

11. The Committee agrees with submissions from representatives of the co-operative movement in Ontario that the present legislative format poses formidable difficulties, particularly to laymen, in ascertaining and interpreting the legislation affecting co-operatives in Ontario, which are compounded by the absence of an official or department whose advice or ruling can be sought on matters arising from the legislation. The present Associate Director of the Farm Economics, Co-operatives and Statistics Branch of the Ontario Department of Agriculture and Food provides valuable informal assistance, but is not vested with any legal authority with regard to co-operatives. The desirability of establishing a Director of Co-operatives in Ontario is considered in Chapter 8.

12. **The Committee therefore recommends** the enactment of a separate Act relating to co-operatives which would be a self-contained, comprehensive and exclusive code of the legislation affecting co-operatives. The Committee would expect that in the drafting of such a separate Act the present inconsistencies in the legislation relating to co-operatives with share capital and co-operatives without share capital would be eliminated.

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1. A Federal Co-operatives Act has recently been enacted (Canada Co-operative Associations Act, S.C. 1970, c.17.) but it is not available to co-operatives operating exclusively within one province.

2. Section 116(1) provides:

> "Section 21a, clauses a to p, s, u and v of subsection 1 and subsection 2 of section 22, sections 58 to 60, 66, 68 to 70, 72 to 74, 75a, 79 and 80, subsection 1 of section 81, section 82, clauses a, b and c of subsection 1 and subsection 3 of section 83 and section 96 apply *mutatis mutandis* to corporations to which this Part applies, and in so applying them the words "company" and "private company" means "corporation" and the word "shareholder" means "member"."

3. Section 116(2) provides:

> "Subsection 1 of section 22, section 69, clauses *a*, *b* and *c* of subsection 1 and subsections 2 and 3 of section 83, subsection 1 of section 84, except clause *a* thereof, subsection 2 of section 84 and sections 85 to 88, 91 and 92 apply *mutatis mutandis* to corporations to which Part V applies, and in so applying them the words "company" and "private company" mean "corporation" and the word "shareholder" means "member"."

4. Report of the Commission in respect of the Affairs of Farmers' Allied Meat Enterprises Co-operatives Limited (FAME Inquiry) 1965.
5. *Ibid.*, p. 22. See further Chapter 20, *infra*.
6. Section 127.
7. Section 132.
8. Section 136.
9. See also the recently enacted Canada Co-operatives Associations Act, *supra*, note 1.
10. Nova Scotia Act, s.2(2).
11. Part X of The Companies Act, R.S.M. 1970, c.C160.
12. Manitoba Act, s.413(5) which provides:

> "The by-laws may provide in a manner inconsistent with the provisions of Part II; and where inconsistent therewith the by-laws shall take effect and be binding upon the corporations and members, instead of the provisions of that Part."

CHAPTER 5

Incorporation

1. Apart from a requirement in section 125 that all co-operative corporations include as part of their corporate name the word "co-operative" and the prohibition upon its use by all other corporations, Part V contains no provisions governing the incorporation of co-operatives. Since co-operative corporations subject to Part V are excluded from the application of The Business Corporations Act,[1] co-operatives with share capital will continue to be incorporated under Parts I and II of The Corporations Act. Co-operatives without share capital are incorporated under Part III of The Corporations Act in the same manner as other corporations without share capital. In both cases applications for letters patent must be filed with the Minister of Financial and Commercial Affairs by not less than three incorporators of full age and capacity containing such information as is required under section 18 for co-operatives with share capital and under section 102 for co-operatives without share capital. In addition, the Department has established the practice of stipulating that the incorporators be persons who are to be members of the co-operative and not merely office incorporators and, presumably under the authority of section 6 of the Act, requires that there be filed with each application a copy of the proposed by-laws and an affidavit of one of the applicants stating the nature of the proposed undertaking, the manner in which surplus funds are to be distributed and the approximate number of members immediately following incorporation. The purpose of the affidavit is apparently to assist the Minister in determining whether or not the application is for a bona fide co-operative.

2. In practice, the application and supporting documents are initially examined as to form and the acceptability of the proposed name by the Companies Branch and are then usually sent for further scrutiny to the Associate Director of the Farm Economics, Co-operatives and Statistics Branch of the Department of Agriculture and Food. The Associate Director examines the application, in some cases may interview the applicants, and reports upon the application to the Companies Branch. On occasion, the Associate Director has indicated to the applicants that the co-operative form did not appear to be suited to the proposed venture and in some cases this has resulted in withdrawal of the application but, so far as the Committee has been able to ascertain, no application in proper form has been denied in recent years by virtue of the exercise of the Minister's discretion.

3. On the basis of evidence available to the Committee, it is difficult to conclude that the ministerial discretion which now exists constitutes a valuable safeguard against misuse of the co-operative charter. The content of the affidavit referred to in paragraph 1 required by the Companies Branch

contains little from which an evaluation of the bona fides of the proposed co-operative can usefully be made. The statement of the nature of the proposed undertaking is usually satisfied by repeating the objects clause, the manner in which surplus funds are to be distributed is satisfied by paraphrasing sections 132 and 133 of Part V, and the approximate number of members immediately following incorporation can only be an estimate. In view of the fact that the ministerial discretion is not, and in the absence of any specific guidelines in the legislation, perhaps cannot be exercised in a meaningful way, some of the criticisms of the letters patent procedure made by this Committee in its Interim Report are relevant with regard to applications for the incorporation of co-operatives[2] and since co-operatives are in essence business corporations imbued with certain ideals and operating according to certain philosophical principles, some of which are enshrined in legislation, there appeared to the Committee to be no compelling reason for retaining a discretion in the incorporation of co-operatives.[3]

4. However, it was submitted to the Committee that "it is necessary to have someone who will exercise a discretion as to the bona fides of an application for a co-operative charter". The Committee therefore considered as an alternative to the present procedure for incorporation, retaining a discretion as in all other provinces[4] including those where the normal method of incorporation is by registration and hence a matter of right, exercisable as at present by the Minister, but vesting in the Director of Co-operatives whose establishment is recommended in Chapter 8, the advisory functions presently exercised on an unofficial basis by the Associate Director of the Farm Economics, Co-operatives and Statistics Branch of the Department of Agriculture and Food. The Director of Co-operatives would receive, examine, consider and report to the Minister on each application to incorporate a co-operative and the Minister would exercise his discretion on the basis of information received.

5. Among the most important arguments generally advanced for retaining a discretion in the incorporation of co-operatives is the special legislative treatment accorded to co-operative corporations in certain areas, principally in the field of taxation. Under section 73(1) of the Income Tax Act[5] most types of co-operatives incorporated under provincial co-operative legislation are exempt from taxation for the first three taxation years after the commencement of business provided they meet the conditions prescribed in the section. Under section 75 of the Income Tax Act,[6] a taxpayer (not merely a co-operative) may deduct in computing income for a taxation year, patronage returns made to members, but the taxable income may not thereby be reduced below 3% of the capital employed in the business at the commencement of the year less the interest paid on certain borrowed moneys. Co-operatives without share capital in Ontario are not liable for assessment under The Ontario Corporations Tax Act because the definition of "corporation" in s.1(1)8 of that Act excludes from its application cor-

porations without share capital.[7] Such co-operatives are nevertheless still entitled under the Income Tax Act[8] to deduct 10% of their taxable income earned in the province computed after deduction of patronage returns.

6. Other legislative benefits enjoyed by co-operatives include a limited exemption from certain provisions of the Combines Investigation Act[9] and, in Ontario, an exemption under The Securities Act[10] and the availability to certain agricultural co-operatives of loans or guarantees under The Co-operative Loans Act.[11] The minimum fee for incorporating a co-operative in Ontario is also significantly lower than that for an ordinary business corporation conducting a similar business.[12]

7. The Committee has not attempted to assess the possible benefits which many co-operatives may derive from the tax legislation since it considers that the incidence of taxation should not influence its consideration of the corporate legislation affecting co-operatives. Nor is the Committee persuaded that the other possible benefits, either individually or collectively, provide a compelling reason for retaining a ministerial discretion in the incorporation of co-operatives.

8. A second major argument usually advanced for requiring a discretion in the incorporation of co-operatives is to safeguard the co-operative movement against abuse of the co-operative form and in particular the misuse of the word "co-operative" as part of the corporate name. It was represented to the Committee that co-operatives are intrinsically different from other business enterprises and that a discretion over the granting of co-operative charters should be retained as a filter to separate bona fide co-operatives from other enterprises which, although organized as co-operative corporations and operated in accordance with such co-operative principles as one member, one vote and patronage returns, are said to lack the underlying philosophical basis of a true co-operative. Such co-operatives, generally referred to as pseudo co-operatives, would it is argued, proliferate were incorporation to be permitted as of right. The argument assumes a clear understanding of the meaning and constituent elements of a "bona fide co-operative" and well-recognized criteria for distinguishing a bona fide co-operative from a pseudo co-operative. But no assistance in this regard is to be found in the legislation and little guidance is available from other sources. The British Columbia Act expressly requires as a condition for approval of an application to incorporate that the Supervisor be satisfied that the proposed association is "organized on a bona fide co-operative basis".[13] That Act defines "co-operative basis" by enumerating the usual co-operative principles,[14] but there is no indication as to what additional factors, apart from the subjective intent of the incorporators, which in any event can best be judged by their actions after incorporation, are required to constitute an association organized

on a "bona fide co-operative basis". The problem of defining a bona fide co-operative is not confined to Canada for the English legislation provides that "a society shall not be registered . . . unless it is shown to the satisfaction of the registrar . . . that the Society is a bona fide co-operative society".[15] The Registrar of Industrial and Provident Societies has attempted to provide extra-statutory guidelines as to what constitutes a bona fide co-operative society in the form of a memorandum but the "observations" of the Registrar are tentatively expressed and do little more than repeat, in language scarcely less abstract, the essential principles of co-operation formulated by the International Co-operative Alliance in 1966. The memorandum of the Registrar is reproduced as Appendix B to this Report.

9. In the absence of legislative guidelines, several extra-statutory rules have been devised to distinguish bona fide co-operative ventures from pseudo co-operatives when evaluating applications for incorporation, one of which appears to have received wide adoption, at least in principle, by some provincial authorities.

10. Most provincial authorities will only permit the incorporation of co-operatives composed of primary producers or ultimate consumers or both, the intention being to discourage co-operatives organized among middlemen which are regarded as the epitome of pseudo co-operatives. However, this rule is not evenly interpreted or uniformly implied by provincial authorities for it appears possible for a group of real estate brokers to establish a co-operative multiple listing agency in Alberta and probably in Ontario, but a similar co-operative would not be permitted by the provincial authorities in Manitoba or Quebec on the basis that it provides no benefit to the primary producer (the vendor) or ultimate consumer (the purchaser). The only persons benefiting are member real estate brokers who are middlemen and the venture is therefore characterized as a pseudo co-operative. No provincial Act explicitly restricts the formation of co-operatives to groups of primary producers or ultimate consumers[16] and it is open to question whether there is any justification today for the premise that they alone should be permitted to use the co-operative form.

11. The co-operative movement in Canada has traditionally been centred among agricultural producers and originated as a defensive means to enable small, independent farmers, exploited by large commercial distributors and other middlemen often acting in combination, to improve their bargaining position so as to obtain a fair price for their produce. Since their common cause was to displace the middleman it is perhaps understandable that the co-operative was considered appropriate to and exclusively in the context of the primary producer or ultimate consumer. But although both consumer co-operatives and agricultural producer co-

operatives have as their common origin a collective response against exploitation by middlemen, operate according to similar methods and within the membership group, perform the identical function of providing goods and services at cost, their ultimate objectives are divergent and perhaps opposed. Whereas the aim of consumer co-operatives is to eliminate all profits and to reduce the cost of living of the members by providing essential goods and services at cost, agricultural producers co-operate for the entrepreneurial purpose of increasing their profits derived from consumers by the savings produced from supplanting the middleman in the marketing of their produce or in the purchase of essential farm supplies.[17] The aim of an agricultural producer co-operative is to enable its members to sell at the best price possible whereas the purpose of the consumer co-operative is to enable its members to obtain goods and services as cheaply as possible.[18] Historical factors, some of which are of questionable relevance today, may account for the restrictions upon the use of the co-operative form[19] to groups of primary producers or ultimate consumers but, analysed in terms of their economic function, if agricultural producers are permitted to organize co-operatives, it is perhaps difficult to perceive any tenable argument for precluding others, including middlemen, from forming marketing or business purchasing co-operatives if it is to their economic advantage to do so. In the United States, where under many State Acts co-operatives may be incorporated as of right without comparable restrictions on their field of membership or type of operation, there exist a number of retailer-owned wholesale co-operatives for the supply of drugs, furniture, groceries, hardware, lumber and building materials, radios and televisions, shoes and transportation.[20] Such retailers are ordinary middlemen who find it to their advantage to obtain their merchandise on a co-operative basis in order to enable them to maintain their competitive position against supermarkets and discount stores. In view of the statutory restrictions upon voting rights and the return on capital, it is unlikely that the co-operative would be attractive to promoters. This is perhaps substantiated by the relatively few attempts in recent years of middlemen in Ontario seeking to incorporate co-operatives. Had they chosen to do so, in the absence of any meaningful discretionary controls they could have obtained co-operative charters.

12. The Committee is of the view that the co-operative movement should be protected from abuse of the co-operative form by those anxious to take advantage of the good will attached to the co-operative name, but does not consider a discretion in the incorporation of co-operatives to be the appropriate means. The exercise of a discretion in the incorporation of co-operatives in other provinces has led to the use of extra-statutory criteria of dubious validity interpreted and applied according to a particular provincial authority's conception of a bona fide co-operative which can have the effect of stifling the possible legitimate uses of the co-operative

form, while in Ontario, where co-operatives are virtually incorporated as of right in the absence of any meaningful exercise of the ministerial discretion to grant letters patent, there appears to be very little evidence of abuse.

13. In the opinion of this Committee whether a venture is a bona fide co-operative cannot properly be determined until it is viewed as a going concern. The Committee therefore recommends that the present ministerial discretion be eliminated and that the incorporation of co-operatives be made a matter of right. The procedure for incorporation should be made substantially the same as that governing the incorporation of a business corporation under The Business Corporations Act, which provides that one or more persons, being a body corporate or a natural person who is of the age of twenty-one years or more may incorporate a corporation by signing and delivering to the Minister in duplicate, articles of incorporation.[21] The Committee has considered whether or not the incorporation of a co-operative should be permitted on the application of one person. Since a co-operative cannot operate as such with only one member, the "one man" corporation should not be allowed. The Committee has recommended in Chapter 15 that the minimum number of directors be five and that all directors be members of the co-operative. Accordingly, the minimum number of incorporators should be not less than five.

14. Once incorporated, the retention of co-operative status should be made dependent upon the continuing observance by the co-operative of co-operative principles and the co-operative method of doing business. The conditions for retaining co-operative status are examined in more detail in Chapter 7.

15. **The Committee therefore recommends** that:

- (a) the incorporation of a co-operative corporation be made a matter of right;
- (b) the procedure for the incorporation of a co-operative corporation be substantially the same as that provided in The Business Corporations Act, with the exception that there should be at least five applicants for incorporation.

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1. The Business Corporations Act, 1970, S.O. 1970, c.25. s.2(2)(b).
2. The Interim Report on the Select Committee on Company Law, 1967, Chapter 1.
3. Co-operatives should be distinguished from credit unions which, although operated on a co-operative basis, are financial institutions, a difference which, in the view of this Committee expressed in its Report on Credit Unions, 1970, Chapter 4, requires a discretionary control over their incorporation.
4. The incorporation procedure in the recently enacted Canada Co-operative Associations Act, S.C. 1970, c.17, s.5. involves the exercise of a ministerial discretion.

5. Income Tax Act, R.S.C. 1952, c.148, s.73(1).

"s.73(1) *3-year exemption.* No tax is payable under this Part upon the taxable income for each of the first 3 taxation years after commencement of its business of a corporation that commenced business on or after January 1, 1947, and that was incorporated under provincial legislation respecting the establishment of co-operative corporations for the purpose of marketing (including processing incident to or connected therewith) natural products belonging to or acquired from its members or customers, of purchasing supplies, equipment or household necessaries for or to be sold to its members or customers or of performing services for its members or customers, if, during the taxation year,

(a) the statute under which it was incorporated, its charter, articles of association or by-laws or its contracts with its members or its members and customers held forth the prospect that payments would be made to them in proportion to patronage,

(b) none of its members had more than one vote in the conduct of the affairs of the corporation,

(c) at least 90% of its members are individuals and at least 90% of its shares, if any, are held by individuals,

(d) the rate of interest on capital subscribed by its members or the rate of its dividends on its shares did not exceed 5% per annum,

(e) the value of the products marketed for or acquired from, supplies, equipment and household necessaries purchased for or sold to, and services performed for, its customers other than members did not exceed 20% of the total thereof for all its business, and

(f) the business carried on by the corporation was not a continuation of a previous business in which a substantial number of its members had a substantial interest, either as shareholders of a corporation carrying on the previous business or otherwise."

6. *Ibid.*, s.75.

"75(1) *Deduction in computing income.* Notwithstanding anything in this Part, there may be deducted, in computing income for a taxation year, the aggregate of the payments made, pursuant to allocations in proportion to patronage, by a taxpayer

(a) within the year or within 12 months thereafter to his customers of the year, and

(b) within the year or within 12 months thereafter to his customers of a previous year, the deduction of which from income of a previous taxation year was not permitted."

7. The Corporations Tax Act, R.S.O. 1960, c.73, s.1(1)8.

"s.1(1)8. "corporation" means a corporation however or wherever incorporated and, where a corporation or the whole or any part of the property thereof is placed in the hands or under the control of an agent, assignee, trustee, liquidator, receiver or other official, includes such agent, assignee, trustee, liquidator, receiver or other official, but does not include a corporation incorporated without share capital."

8. Income Tax Act, s.40(1).

9. One characteristic feature of co-operatives, that of making patronage returns only to members, could constitute an illegal practice as a discriminatory "discount, rebate, allowance (or) price concession" prohibited under the Combines Investigation Act, R.S.C. 1952, c.314, as amended S.C. 1960, c.45, s.13 were there not a specific exemption in s.33A(3) of that Act for co-operative societies. Since there is no definition of "co-operative societies" in the Combines Investigation Act, this exemption would seem to apply to unincorporated associations and ordinary corporations organized so that their business is conducted on a co-operative basis as well as to co-operative corporations subject to Part V.

10. Corporations "operated on a co-operative basis as defined by Part V of The Corporations Act" are exempt from the general obligations to file a prospectus and to register the salesmen of their securities with the Ontario Securities Commission by virtue of s.19(2)7 of The Securities Act, 1966. There is no definition of a co-operative operated on a co-operative basis in Part V, but as a matter of practice any co-operative subject to Part V is considered entitled to the benefit under the exemptions. The Ontario Securities Commission has power under s.19(5) to

revoke the exemptions "where in its opinion such action would be in the public interest". Whether the present exemptions, which are not found in all provincial legislation, should be retained in their present form is examined together with other aspects of the control over the issue of securities by co-operatives in Chapter 19, *infra*.

11. The Co-operative Loans Act, R.S.O. 1960, c.67, empowers the Co-operative Loans Board to make mortgage loans up to $100,000 for a maximum term of 20 years and to guarantee, without limit, loans made to "co-operative corporations of producers of farm products to which Part V of the Corporations Act applies". The availability of loans and guarantees to agricultural co-operatives subject to Part V represents part of the provincial program to assist agriculture and has little bearing as a factor in deciding whether the incorporation of co-operatives should be as a matter of right, since the only possible effect in the event of an agricultural co-operative being incorporated today would be to render it eligible but not entitled to assistance under The Co-operative Loans Act. Furthermore, although a number of co-operatives have benefited from The Co-operative Loans Act over the years, there are certain misgivings in that the view is taken that co-operatives eligible to receive loans or guarantees under The Co-operative Loans Act are ineligible to receive loans and other financial assistance from the Ontario Development Corporation.

12. The minimum fee for incorporating a co-operative organized with or without share capital is $20 whereas, the minimum fee for incorporating a business corporation intended to conduct a similar enterprise is $125. Where the authorized capital of a co-operative exceeds $40,000, the scale of fees is identical with that applicable to ordinary corporations. See R.R.O. 1960, Reg.61, Schedule 1, as amended by O.Reg.103/62, O.Reg.203/62, O.Reg.296/62, O.Reg.11/65 and O.Reg.313/65.

13. British Columbia Act, s.6(3).

14. *Ibid.*, s.2.

15. Industrial and Provident Societies Act, 1965, (13-14 Eliz.II)c.12 s.1(2)(g).

16. One provision of the Quebec Act would appear to prohibit certain "middleman co-operatives". s.75 provides:

    "s.75. No member of an association shall obtain property or services from it for resale for profit."

17. It is sometimes suggested that farmers are "ultimate consumers" of the goods they obtain from their farm supply co-operative. These are however, "producer" goods distinguishable from goods supplied to members of consumers' co-operatives which are "consumer" goods for final consumption, a distinction recognized by the Income Tax Act which treats patronage returns received by farmers as a reduction in the cost of production and therefore as taxable income whereas patronage returns received in respect of "consumer goods or services" are not includible as income. Income Tax Act, R.S.C. 1952, c.148, s.75(6).

18. The essential differences between the objectives of agricultural producer co-operatives and consumer co-operatives, have been succinctly analysed by M. Digby, *The World Co-operative Movement*, pp.141-142.

    "The principle which unites co-operators of all categories is the method by which they seek to conduct economic activity, a method which aims at complete equality and the elimination of competition and individual profit-seeking *within the group*. But the object of this activity is really and profoundly different in the case of a consumers' and a producers' organization. The consumer is seeking to supply himself with the best goods with the greatest economy of production. It is not a primary object but rather a matter of conscience, and co-operators are generally conscientious, that the price should be fair to the producer and that, in general, the manner of work of the producer, as well as the reward he receives for it, should provide him with a satisfying way of life. The producer, on the other hand, is seeking to make a living in the place and with the resources of land, raw materials and skill at his disposal. He is not, except as a matter of conscience, interested in the price which the consumer has to pay, or even (and this is more fundamental) whether the consumer is getting the type of goods he most wants to receive, provided he does not refuse to take them altogether."

    These basic ideological differences led to a controversy among co-operative theorists, which is still unresolved, concerning the legitimacy of producer co-operatives, existing exclusively to advance the interests of producers. Some

co-operative theorists regard co-operatives as the organization of all economic activity by associations of ultimate consumers and reject as spurious enterprises agricultural co-operatives which are not owned by consumers. Other theorists adopt a socialistic view of co-operation and emphasize the common social origins, "the pinch of acute need" which prompted agricultural and consumer co-operation, and the social values in the co-operative method as a collective enterprise. Experience in England, where consumer co-operation is dominant, has indicated that farming is an industry which does not readily lend itself to consumer control and this factor, coupled with the growth of agriculatural co-operatives of many countries, has caused some consumer advocates to modify their policy if not their ideals.

See further A. M. Carr-Saunders, P. S. Florence, R. Peers, *Consumer's Co-operation in Great Britain* (1938); M. A. Abrahamsen & C. L. Scroggs, *Agricultural Cooperation: Selected Readings* (1957); S. Pollard, *The Co-operative at the Crossroads* (1965).

19. Particularly in view of the increasing use of marketing boards which guarantee a minimum price to the producer of a controlled product. See further Chapter 23, *infra.*
20. See E. P. Roy, *Cooperatives: Today and Tomorrow* (2nd ed. 1969) pp. 167 *et seq.*
21. The Business Corporations Act, 1970, *op. cit. supra,* note 1, s.4.

CHAPTER 6

Name

1. Co-operatives subject to Part V are required to include the word "co-operative" as part of their corporate name. The Act also provides in section 125(3) that "no person not being a corporation to which this Part applies shall use in Ontario a name that includes the word 'co-operative' or any abbreviation or derivation thereof whether or not the word, abbreviation or derivation is used in or in connection with the name".

2. It is a matter of some concern to the co-operative movement that a business or organization which is not a true co-operative corporation not be permitted to use or trade on the word "co-operative". The Committee has been advised that there is some misuse of the word co-operative by organizations which are not co-operative corporations which may have been encouraged by the limited scope of section 125(3) which prohibits only "persons" from using the word co-operative. This section would, therefore, seem not to prohibit unincorporated associations, partnerships or other groups who are not "persons", as defined by The Interpretation Act, to make use of the word co-operative whether or not they are in fact organized as a co-operative.[1] Before the enactment of The Corporations Act in 1953 the corresponding section in the co-operative Part provided:[2]

> (3) Any person, partnership, organization, society, association, company or corporation, either unincorporated or incorporated, not being a corporation subject to this Part, using in Ontario a name which includes the word "co-operative" or any abbreviation or derivation thereof shall be guilty of an offence, and any person using such name on behalf of such person, partnership, organization, society, association, company or corporation shall also be guilty of an offence.

3. **The Committee recommends** that to remove any doubt, the present provision of the Act be enlarged to prohibit, prospectively, any partnership, organization, society or association from using the word "co-operative" or "co-op" as part of its name or in any manner in connection with the conduct of its business so as to give the impression that its business is conducted upon a co-operative basis.

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1. The Interpretation Act, R.S.O. 1960, c.191, s.30.
2. R.S.O. 1950, s.141(3).

CHAPTER 7

Maintenance of Co-operative Status

1. One of the principal features which distinguish a co-operative from other forms of business enterprises is its mutual nature. In a bona fide co-operative there is and should be a substantial identity between the members and the patrons. Most co-operatives do and should be permitted to transact some business with non-members but it is fundamental to the nature of the co-operative as a mutual type association that its goods and services be furnished primarily to and for the use of the members.[1] Accordingly, the Committee is of the view that a co-operative should be required, as a condition for retention of its co-operative status, to transact a certain minimum percentage of its business with members and that the legislation should impose a specific limit on the permitted amount of non-member business which, although of necessity arbitrary, would embody in enforceable form the mutual nature of the co-operative and would serve to discourage the misuse of the co-operative form for non co-operative purposes.

2. There is presently a provision in section 141 of Part V, introduced in 1949[2] but thus far never used, under which the Lieutenant Governor in Council is empowered to remove the co-operative status of a corporation which has transacted 50% or more in value of its business with non-members during the relevant fiscal year. However, that section is of doubtful value since at present there is no means by which the Lieutenant Governor in Council can become informed of the amount and proportion of member and non-member business in any year except by voluntary disclosure on the part of the co-operative itself. The section is, therefore, more likely to be used as the side note suggests, as a "provision for relief" by co-operatives seeking an inexpensive and convenient means of converting to an ordinary corporation.

3. Co-operatives that do most of their business with non-members have left the co-operative fold. The Committee recommends that the legislation make it mandatory for a co-operative to transact a minimum of 50% in value of member business as a rule of thumb condition for the retention of co-operative status, a percentage which corresponds with that in section 141 and also with the provisions of certain United States co-operative statutes.[3] This percentage is lower than the provision in section 73(1) of the Income Tax Act which requires newly incorporated co-operatives to conduct at least 80% of their business with members in order to qualify for the tax exemption in the first three years of business.[4] Economic reasons might force a co-operative to transact more than 20% of its business with non-members, even at the cost of the tax exemption in section 73(1) and, given the present ratio of member and non-member business[5], the Committee considers a minimum of 50% member business more realistic. In

order that a co-operative should not lose its co-operative status as a result of wholly exceptional trading circumstances, the Committee recommends that the qualifying percentage of member business be calculated on a three year running average. The Minister should be required under the legislation to order the conversion of a co-operative into a business corporation when it fails to transact the required minimum of member business unless the co-operative can establish to the satisfaction of the Minister that the order should not be made. No order should in any event be made before due notice and adequate opportunity to make representations to the Minister have been given to the co-operative.

4. In Chapter 18 of this Report it is recommended that the financial statements of a co-operative corporation contain information respecting the amount of member and non-member business for the relevant period. In Chapter 9, it is recommended that the powers of the proposed Director of Co-operatives include the power to request such information as he deems necessary to satisfy himself that a co-operative is complying with the provisions of the Act and in Chapter 10 that, upon requisition by members or under the direction of the Minister, the Director of Co-operatives should be required to investigate the affairs of a co-operative to ensure the observance of the minimum member business requirement and other requirements of the legislation.

5. These recommendations are designed to provide a framework to ensure that a co-operative, once incorporated, will continue to act as a bona fide co-operative. In the view of the Committee they will provide a more effective method to accomplish this result than the requirement of a discretion at the time of incorporation.

6. **The Committee therefore recommends** that:

(a) the legislation provide that a co-operative be required to conduct a minimum of 50% of its business with its members;

(b) the minimum of 50% of member business be calculated on a three year running average;

(c) the Minister be required to order the conversion of a co-operative into a business corporation when it fails to transact the minimum amount of member business unless the co-operative can establish to the satisfaction of the Minister that the order should not be made;

(d) no such order be made until after due notice to the co-operative and an adequate opportunity given to it to show cause why the order should not be made.

1. "As a matter of practical expediency, it does appear to be important that co-operative associations should not be prevented from handling the product of non-

members under any or all circumstances. On the other hand, it would seem that permitting them to deal upon such terms as they see fit in the product of outsiders reduces them to the level of a profit sharing form of organization, and virtually destroys the force of any claim which they might make for special consideration on the basis of having a character distinct from that of the ordinary commercial corporation". E. G. Nourse, *The Legal Status of Agricultural Co-operation* (1928) pp. 255-6.

2. Section 141 of the Act provides:

   "s.141. The Lieutenant Governor in Council may declare that a corporation is no longer subject to this Part and change such corporation's name, if it appears to the Lieutenant Governor in Council that 50 per cent or more in value of the business of the corporation during its last fiscal year was transacted with persons or corporations that were neither members nor shareholders of the corporation."

3. E.g. Kentucky Cooperative Corporations and Agricultural Associations Act, K. R.S.272.211, provides:

   "If an association transacts business with non-members, the same must not exceed in amount the total business transacted by the association for its members."

   See also s.6. of The Capper-Volstead Act, 1922 (7 U.S.C.A. 291) which imposes a similar requirement as one of the conditions for relieving agricultural marketing co-operatives engaged in interstate commerce from some of the rigours of The Sherman Anti-Trust Act, 1890 (15 U.S.C.A. 1) .

   See generally, J. K. Savage, The Economic and Legal Affects of Non-Member Business on Farm Cooperatives in Wisconsin, *1954 Wisconsin Law Rev.* 670, pp. 680ff.

4. It is also lower than the minimum percentage of member business required of agricultural or forestry co-operative associations in England as a condition for obtaining exemption from Part I of the Restrictive Trade Practices Act, 1956 (4 & 5 Eliz.II) c.68, which is fixed by statutory order at 66⅔% calculated on a three year average.

5. According to the 1966-67 Survey of the Ontario Department of Agriculture and Food (1968) p.28, member transactions averaged 66% of total business. The Survey noted that:

   "a marked trend in the increase of non-member business from 26.6 percent to 33.8 percent was apparent between 1961-62 and 1966-67. The increase in the percentage of non-member business was greater among marketing co-operatives with an 8.6 percent increase than among distribution co-operatives with an increase of 5.8 percent."

   Another factor influencing the selection of 50% member business as the minimum required to qualify as a co-operative is the distribution of farm supply co-operatives in Ontario. It would appear that in certain areas farm supplies are available only from the co-operative with no local alternative source of supply for those not wishing to join the co-operative.

CHAPTER 8

Director of Co-operatives

1. Unlike the legislation of every other province, there is in Ontario no provision in the Act for the establishment of a government official responsible for the administration of co-operative legislation and variously known as a Registrar,[1] Supervisor[2] or Inspector[3] of Co-operatives. Co-operatives in Ontario, like all corporations governed by The Corporations Act, are subject to the jurisdiction of the Minister of Financial and Commercial Affairs exercised by the Companies Branch. As a matter of practice, however, the primary source of inquiry and information for all matters respecting co-operatives is the Associate Director of the Farm Economics, Co-operatives and Statistics Branch of the Department of Agriculture and Food, who has wide experience and a considerable knowledge of the law and administration of co-operatives. The role of the Associate Director is entirely extra-statutory for there is nothing in the Act to associate the Department of Agriculture and Food with the administration of the legislation affecting co-operatives much less a provision which invests the Associate Director with any power or responsibility in that regard.

2. The present arrangement which has existed for several years is well established but is, in the view of the Committee, unsatisfactory from the point of view of the provincial authority and the general public. Although the interposition of the Associate Director between the Companies Branch and persons concerned with co-operatives provides a degree of expertise in the specialized field of co-operative legislation which would otherwise be lacking, difficulties might arise if the legal authority of the Associate Director were put in question. So long as the present administrative practice could be regarded as an internal, inter-departmental, consultative service, the legal status, or lack of it, of the role of the Department of Agriculture and Food remained relatively unimportant, but this arrangement seems to have developed over the years from an advisory service to one of dependency. The Associate Director is presently in the invidious position of being liable to have his status questioned where his advice was unfavourable and being relied upon as authority for a particular course of action which he may have approved.

3. As previously stated, every provincial Act with the exception of Ontario provides for the appointment of a government official charged with the responsibility of administering the legislation affecting co-operatives.[4] In eight of the provinces an official has been appointed, the single exception being British Columbia where, although the British Columbia Act provides for the appointment of a Supervisor of Co-operatives, none has yet been appointed and pending such appointment

his duties are carried out by the Registrar of Joint Stock Companies as provided for under that Act.[5]

4. There is little uniformity in the title, status, powers and duties of these various government officials. In Saskatchewan, where the co-operative movement is the largest and most highly developed in Canada, the Deputy Minister of the Department of Co-operation and Co-operative Development is, ex officio, the Registrar of Co-operatives and also Registrar of Credit Unions.[6] In Alberta and Manitoba, which also have large co-operative movements, the administration of co-operative legislation is combined with credit union legislation and under a special Co-operatives and Credit Unions Services Branch of the Department of Industry and Tourism and the Department of Agriculture and Conservation, respectively, headed by a Director who also holds office as the Supervisor of Co-operatives. In New Brunswick and Newfoundland, the administration of co-operatives and credit unions is combined under the Director of Co-operatives and Credit Unions and the Registrar of Co-operative Societies, respectively. In Nova Scotia and Prince Edward Island, on the other hand, the Inspector of Co-operatives is responsible only for co-operatives and credit unions are administered by an official under the jurisdiction of a separate department. In Quebec, since 1967, co-operatives are administered by an Associate Deputy Minister of the newly created Department of Financial Institutions, Companies and Co-operatives.

5. The Committee received several submissions advocating the establishment in Ontario of a government official with functions similar to those of the Registrar, Supervisor or Inspector of co-operatives in other provinces. The Committee considers it important to both the existing co-operative movement and to the general public that there exist some authoritative source to provide information and guidance on all aspects of the legislation relating to co-operatives. There appears to be a growing public interest in Ontario in the use of the co-operative as evidenced by the emergence of the direct charge grocery co-operative but in the absence of a government official responsible for co-operatives and a widely supported provincial organization of the co-operative movement there is no convenient means of obtaining advice in this specialized field. The Committee is also advised that the Associate Director frequently receives requests from existing co-operatives for advice on legal or administrative problems and has on occasion acted as an informal arbiter of disputes arising among the membership of a co-operative.

6. For these reasons, the Committee recommends that the legislation respecting co-operatives in Ontario should make provision for the appointment of an official to be called the Director of Co-operatives who would be responsible for administering the legislation affecting co-operatives, to act generally as an official source of guidance and information for those con-

cerned with or interested in co-operatives and whose functions, powers and duties would include but not necessarily be limited to those specified in Chapters 9 and 10.

7. The Director of Co-operatives should be responsible to the Minister of Financial and Commercial Affairs since, despite their traditional association with agriculture, co-operatives are a species of corporations and should therefore be governed by the Department vested with general jurisdiction over corporations.

6. **The Committee therefore recommends** that:

(a) the legislation respecting co-operatives provide for an official to be known as the Director of Co-operatives;

(b) the Director of Co-operatives be responsible for administering the legislation affecting co-operatives and act as a source of guidance and information for those concerned with or interested in co-operatives;

(c) the functions, powers and duties of the Director of Co-operatives include, but not necessarily be limited to, those specified in Chapters 9 and 10;

(d) the Director of Co-operatives be responsible to the Minister of Financial and Commercial Affairs.

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1. Saskatchewan, Manitoba.
2. Alberta, British Columbia, Prince Edward Island.
3. New Brunswick, Nova Scotia.
4. In the recently enacted Canada Co-operative Associations Act, S.C.1970, c.17, the Minister of Corporate and Consumer Affairs is responsible for co-operatives and there is no provision for the appointment of a government official to exercise day to day control. However, since the Act applies only to the relatively few large co-operatives carrying on business in more than one province the need for such an official is much less.
5. British Columbia Act, s.2(b).
6. Saskatchewan Act, s.3.

CHAPTER 9

Powers and Duties of the Director of Co-operatives

1. There is a wide variation among provincial Acts concerning the functions, powers and duties of a Director of Co-operatives or his equivalent. In substance such differences as exist reflect the basic attitude of the particular province towards the nature and status of the co-operative corporation, i.e. whether a co-operative is basically an ordinary corporation conducting its business in a particular manner or instead, a quasi-public body to be regulated accordingly. There are, however, at least some functions common to the government official in every province which the Committee considers should also form part of the responsibilities of the Director of Co-operatives recommended for Ontario.

2. The Director of Co-operatives in every province is vested with some function with respect to the incorporation of co-operatives ranging from providing general advice and assistance to applicants and examining applications for incorporation (a responsibility common to all provincial authorities) to evaluating the application and exercising a discretion either solely or in conjunction with the appropriate Minister in that province. For reasons examined in Chapter 5, the Committee has concluded that the incorporation of co-operatives in Ontario be a matter of right and, accordingly, the function of the Director of Co-operatives in Ontario regarding the incorporation of co-operatives would necessarily be limited to providing general advice and assistance to persons wishing to incorporate a co-operative.

3. Each of the nine provincial Acts which establish the equivalent of the proposed Director of Co-operatives requires that the by-laws enacted by co-operatives be filed with the Director of Co-operatives and receive his approval as a condition of their validity. There has never been a requirement that the by-laws of a co-operative in Ontario receive the prior approval of the provincial authority, although between 1917 and 1949 the predecessors of Part V required that all by-laws of a co-operative and amendments thereto, be filed with the Provincial Secretary within 30 days after enactment and were not valid unless so filed.[1] The relevant provision was amended in the 1949 revision of the co-operative Part to provide that copies of all by-laws of a co-operative be filed with the Provincial Secretary within 30 days after confirmation by the members or shareholders, but the act of filing was no longer a condition precedent to the validity of the by-law.[2] If by-laws are effective upon their enactment by the co-operative without any requirement for prior official approval of their contents and regardless whether they are in fact filed, the present obligation to file copies of by-laws with the Minister would seem to serve no useful purpose. The requirement to file copies of by-laws, on the other hand, could have

certain undesirable effects. Firstly, it might encourage the false impression held by some that the filing of a copy of a by-law imports official sanction of its contents when the Minister is in law unconcerned with their contents. Secondly, the obligation to file copies of by-laws renders them in law public documents with the effect that those dealing with the co-operative are deemed to have constructive notice of the contents of the by-laws and it is exceptional for the by-laws of a corporation incorporated by letters patent to be public documents. It therefore appeared to the Committee that the requirement to file by-laws should either be coupled with a requirement that by-laws receive the prior discretionary approval of the Director of Co-operatives as in other provinces, or that the obligation to file copies should be eliminated.

4. The Committee can see no justification for introducing a requirement that the by-laws of a co-operative be subject to the prior approval of a government official to be effective. The proposed Director of Co-operatives would, under his general advisory functions, provide upon request any necessary guidance and assistance as to the possible and desirable contents of the by-laws of a co-operative, but should not be vested with a discretionary power to approve by-laws as a condition precedent to their validity.

5. The Committee therefore recommends that the present obligation to file copies of all by-laws with the Minister be eliminated. The Director of Co-operatives would be able to obtain copies of the by-laws of a co-operative if he so desired under his general power to obtain information recommended by the Committee in paragraph 8 of this Chapter without submitting the by-laws of a co-operative to the adverse effects of the doctrine of constructive notice.

6. All provincial Acts either require the filing of certain specified information, which invariably includes the Annual Return, or empower the Director of Co-operatives or his equivalent to request such information as he in his discretion desires. In both cases the purpose of such information is to enable the provincial authority to protect the interests of the members by ensuring that a co-operative is acting in accordance with the particular legislation, and with co-operative principles and also that the co-operative is not being grossly mismanaged.

7. Co-operatives in Ontario are presently required to file with the Minister annual returns containing basically the same information as that required of a business corporation and are in addition required to file with the Minister, within 10 days after the annual general meeting, copies of their financial statements and auditors report. The Committee considers it is essential, if a co-operative is to maintain its co-operative status, that it conduct a specified percentage of its business with its members and in Chapter 18 has recommended that the volume and percentage of member and non-member business be disclosed in the financial statements of a

co-operative. If the Director of Co-operatives is effectively to carry out his duty to ensure that co-operatives operate in accordance with the Act, and in particular is conducting a sufficient proportion of its business with members, he must have access to the financial statements. The Committee therefore recommends that the present requirement to file financial statements be continued.

8. To enable the Director to obtain relevant information for the discharge of his duties, the Committee recommends that the Act contain a provision similar to sections 412(1) and (2) of the Manitoba Act[3] which provides:

> "427(1) Every corporation shall furnish to the registrar upon his request such information as he may require for the purposes of
>
> (a) compiling statistical records and information; or
>
> (b) facilitating the carrying on of research projects; or
>
> (c) satisfying himself that compliance is being made with this Part by all persons and corporations to whom or to which the provisions apply.
>
> (2) The registrar shall not disclose to any person or corporation information received pursuant to subsection (1), except on the written instructions of the Minister of Agriculture and Conservation signed by him, or in a return made to an order of the Legislative Assembly."

9. **The Committee therefore recommends** that:

(a) the function of the Director of Co-operatives with respect to the incorporation of a co-operative be limited to general advice and assistance but not extend to a discretion with respect to incorporation;

(b) the present provision of the legislation requiring by-laws and amendments to by-laws of a co-operative to be filed with the provincial authority be eliminated;

(c) the present provision of the legislation requiring the financial statements of a co-operative to be filed with the provincial authority be retained;

(d) the legislation contain a provision similar to that contained in sections 412(1) and (2) of the Manitoba Act which would require co-operatives to furnish information to the Director of Co-operatives upon his request.

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1. An Act to Amend the Companies Act, S.O. 1917, c.38, s.152*q*, repealed by An Act to Amend the Companies Act, S.O. 1949, c.14.
2. *Ibid.*, s.156.
3. Companies Act, R.S.M. 1970, c.C160.

CHAPTER 10

Remedial Powers

1. Prior to an amendment in 1949, the Act contained a provision which empowered the Provincial Secretary, upon the application of any 10 members or upon the application of more than one-third of the total number of members, (i) to require the corporation to make a return upon any special subject, (ii) to appoint an accountant to audit the books of the corporation, (iii) to appoint an inspector, and (iv) to call a special meeting of the corporation.[1] For a reason not apparent to the Committee the section was repealed in 1949[2] and the members of a co-operative have since had to rely on the limited statutory powers to intervene in the affairs of a co-operative available under section 321 of the Act.

2. Under section 321, the holders of 10% of the voting shares of a co-operative with share capital, or 10% of the members of a co-operative without share capital, may apply to the court for the appointment of an inspector to investigate the affairs and management of a co-operative or for a court supervised audit of its books. Section 186 of The Business Corporations Act permits such an application to be made by any shareholder. The Committee considers that a similar right should be available to a shareholder or member of any co-operative and recommends that the legislation relating to co-operatives contain a provision similar to section 186 of The Business Corporations Act, but expanded to apply to members of co-operatives without share capital.

3. Because of what has been described to the Committee as a traditional reluctance of members of a co-operative to litigate or to resort to other formal means for resolving intra-co-operative disputes, any statutory remedies available to an individual member or minority of the members of a co-operative are unlikely to be used except in extreme cases. The real protection to members would appear to lie, as in other provinces, in their right to recourse to the proposed Director of Co-operatives or to the Minister.

4. In recognition that a basic function of the Director of Co-operatives is to protect the interest of the members, all provincial Acts empower or require either the responsible Minister or the equivalent of the Director of Co-operatives acting independently, upon direction of the Minister or by requisition of a group of members, to intervene in the affairs of a co-operative. There is little uniformity among the provisions of the respective Acts which seem to vary according to the degree to which the co-operative is identified as a species of business corporation or as a quasi-public institution.

5. After reviewing the legislation of other provinces the Committee concluded that the Director of Co-operatives should be empowered upon

his own initiative or required upon direction of the Minister or upon requisition of the lesser of 25 members or one-third of the membership of a co-operative, to conduct an investigation into the affairs of a co-operative. The results of any investigation of the Director of Co-operatives should be reported to the Minister who, if he is satisfied that the affairs of a co-operative are not being conducted in accordance with the Act, should be empowered to commence proceedings for the winding up of the co-operative, order an audit of that co-operative's books, convene a general meeting of the co-operative or order the conversion of the co-operative to an ordinary business corporation, subject always to the right of the co-operative to make representations as to why such order should not be made. An individual member who is unable to muster the necessary support to requisition the Director of Co-operatives, or who is unsatisfied with the measures taken by the Minister, may still seek relief from the court under the provision referred to in paragraph 2.

6. **The Committee therefore recommends** that:

(a) the Director of Co-operatives be empowered on his own initiative and required, upon the direction of the Minister or the lesser of 25 members or one-third of the membership of a co-operative, to conduct an investigation into the affairs of a co-operative;

(b) the Director of Co-operatives be required to report upon the results of any such investigation to the Minister;

(c) the Minister, if he is satisfied as a result of such investigation that the affairs of a co-operative are not being conducted in accordance with the Act, should be empowered to commence proceedings for the winding up of the co-operative, to order an audit, to convene a general meeting or to order the conversion of the co-operative to a business corporation;

(d) the legislation respecting co-operatives contain a provision similar to that contained in section 186 of The Business Corporations Act, but expanded to apply to members of a co-operative without share capital.

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1. R.S.O. 1937, c.251, s.157.
2. S.O. 1949, c.14, Part XII.

CHAPTER 11

Membership

Admission, Termination, Expulsion

1 Appearing first in the list of basic co-operative principles expounded by the Rochdale Society of Equitable Pioneers in 1844 was that of open membership and this principle was listed as one of four fundamental principles of co-operation by the International Co-operative Alliance in 1937.

2. It should be noted, however, that the principle of open membership was framed originally in the context of a consumer co-operative movement and that membership in other types of co-operatives has traditionally been "selective" rather than "open". In agricultural marketing co-operatives, membership is open only to eligible agricultural producers and is further limited by the size of the co-operative market. There can be no "open membership" in either housing co-operatives or direct charge co-operatives. A practical restriction on membership to those who can make use of the services of the co-operative and by the capacity of the co-operative's available facilities is, in effect, fixed in advance.

3. Furthermore, since the inception of the co-operative movement, admission to membership has always been subject to the discretion of the directors as it was recognized that a harmonious membership was an important factor in the success of a co-operative. The need to maintain harmony within the membership is also linked with the power of a co-operative to expel egregious members and is considered further in this Chapter.

4. Thus from the standpoint of its practical application, the principle of open membership has never been more than an aspiration in the context of the consumer co-operative movement in which it was framed, and is applicable if at all only with reservations to other types of co-operatives. The problems inherent in the principle of open membership were recognized by the International Co-operative Alliance in 1966 which in its Reformulation of the essential co-operative principles emphasized the absence of any arbitrary social, political, racial or religious discrimination in the selection of membership rather than any unlimited right to membership.

5. The Act is silent on the principle of open membership and the admission of members is left to the discretion of the directors. Section 112 of the Act, which is applicable to co-operatives without share capital, provides that the directors may pass by-laws to regulate, among other things, the admission of persons and unincorporated associations as members and the qualification of and conditions of membership. There is no similar provision relating

to co-operatives with share capital and membership, here, depends on the discretionary allotment and issue of shares by the directors. Transfer ot membership is also regulated by the directors since section 129 provides that no shares of a co-operative with share capital or membership in a co-operative without share capital may be transferred unless authorized by the board of directors.

6. The Committee considered whether the Act should contain some statement to give effect to the so-called open membership principle which would impose certain limitations on the discretion of directors of a co-operative when considering applications for membership or transfers of memberships. It is the Committee's view that those involved in the co-operative movement are aware of and respect the general co-operative principles concerning membership and that it is better left to the movement itself to observe its own principles than to attempt to provide for such a matter in legislation. If there happens to be a case of alleged discrimination in the admission of a member based on social, political, religious or racial grounds, the prohibition of which form the essence of the principle of open membership in its modern context, the matter appears to the Committee to be a problem for the Human Rights Commission rather than co-operative legislation. This might entail some amendments to the Ontario Human Rights Code.[1]

7. The membership of a co-operative should be composed to a large extent of members who are active patrons. In the course of time, a member of a co-operative may no longer be able to use the services of his co-operative either because of removal from the area in which the co-operative operates, retirement or other cause and may wish to withdraw from membership and recoup his investment. An unusual number of withdrawals could impose a financial hardship on the co-operative if it were required forthwith to repay a retiring member's investment. To permit an unqualified right to recover the whole of the member's investment in a co-operative upon withdrawal might also encourage a member with a large investment to bring pressure to bear on the management of a co-operative by threatening to withdraw. A balance must therefore be found between maintaining voluntary membership and its corollary of a right to withdraw while protecting the financial stability of a co-operative.

8. There is presently no provision for the retirement of a member of a co-operative or for the repayment to a member of his investment in a co-operative in the event he is unable to use the services of the co-operative. Such a member is dependent upon the discretion of the directors of the co-operative either to repurchase his shares or to approve the transfer of his membership and to repay him any other amounts which may be owing to him. The Saskatchewan Act recognizes the right of a member to withdraw and provides that the directors shall, within six months after receipt of a member's application to withdraw, purchase at their par or paid up value

all shares held by the member and repay him all other equities held to his credit. Further provision is made for an extension of time for payment if in opinion of the directors the financial stability of the co-operative would be impaired but the extension cannot exceed one year unless approved by the members and by the Registrar of Co-operatives.[2] The Alberta Act also contains provision for the withdrawal of members and the payment to them of their investment in the co-operative.[3]

9. Although there was little evidence submitted to the Committee that the present position in Ontario causes any real difficulty, the Committee has nevertheless concluded that the legislation should contain some provision to provide for the repayment of the investment of a retired member. It may very well be however, that a retired member may wish to leave his investment in the co-operative and the legislation should permit this. The framework which commends itself to the Committee is that if a member of a co-operative wishes to withdraw he should so notify the co-operative and state whether or not he wishes the co-operative to repay his investment; the co-operative should be required to repay the investment within six months other than term loans which should be payable only at maturity, and, in order to protect the co-operative from financial strain, subject to the power of the directors to delay repayment for a further period of one year and, with the approval of the Director of Co-operatives, for an additional period.

10. Of equal importance to the maintenance of an active and harmonious membership in the co-operative is the power of a co-operative to terminate the membership of members who may tend to have a disrupting influence. The conditions for cancellation of membership vary considerably among the provinces. The provisions of the Act in this respect are few and there is no clear right recognized in the Act for a co-operative to terminate the membership of any member. Section 128 provides that a co-operative without share capital may terminate the membership of a member who has died or has not transacted any business with the co-operative for a period of two years and upon such termination the co-operative is required to pay any money owing to the member. Section 135 provides that a co-operative with share capital may purchase for redemption the shares of a member or require the transfer of such shares to another person if the member has failed for a period of two years to transact any business with the co-operative or in the case of a corporate shareholder where it is about to be dissolved. It is noted that there is no right given to a co-operative with share capital to terminate a membership consequent upon death. Apart from these provisions, a co-operative without share capital would appear to have the right pursuant to a by-law passed under authority of section 112 to provide for the suspension and termination of membership but there is no similar right vested in a co-operative with share capital. The Committee is of the

view that the Act should recognize a clear right to terminate the membership of a member by expulsion. The right of termination should be vested in the directors and exercised at a duly constituted meeting of directors. The member whose membership is sought to be terminated should be given at least ten days advance notice of the proposal and should be allowed to be present at the meeting to make submissions. Such member should have the right to appeal a termination to the members of the co-operative at a duly constituted meeting and the directors should be required to convene such a meeting at the request of the member. The Committee also is of the view, that, if the membership of a member is expelled by the co-operative, the co-operative should be obliged to pay to such member within one year of the date of termination, his investment in and moneys owed to him by the co-operative, except for any term loans which should continue to be payable in accordance with the terms of the loan.

11. **The Committee therefore recommends** that:

(a) the legislation relating to co-operatives not contain any statement or provision on the matter of open membership;

(b) the question of admission to membership in a co-operative with or without share capital remain a matter for action by the board of directors;

(c) the present provision requiring transfer of membership to be approved by the board of directors be retained;

(d) if a member of a co-operative wishes to withdraw from the co-operative he should notify the co-operative and state whether he wishes the co-operative to repay his investment;

(e) if a member of a co-operative wishes to withdraw and to have the co-operative repay his investment, the co-operative be required to repay such member's investment, except term loans, within six months with the right to the directors of the co-operative to extend such period for a further period of one year and, with the approval of the Director of Co-operatives, for a further period beyond that;

(f) the legislation recognize the right of a co-operative, either with or without share capital, to expel a member by action taken at a duly constituted meeting of directors of the co-operative;

(g) the member sought to be expelled be given at least ten days notice in advance of the convening of the meeting of directors and given an opportunity of making submissions at the meeting;

(h) a member expelled by action of the directors have the right to appeal the expulsion to the members of the co-operative at a duly

constituted meeting which the directors should be required to convene at the request of the expelled member;

(i) the investment of an expelled member, except term loans, be repaid within one year of the termination of membership by expulsion.

1. S.O. 1961-62, c.93, as amended.
2. Saskatchewan Act, s.30.
3. Alberta Act, s.39.

CHAPTER 12

Membership

Voting Rights

1. All of the various statements of co-operative principles which have been formulated from time to time have included democratic control as a fundamental principle. As interpreted by the Rochdale Pioneers, the essence of democratic control was that every member should have one but only one vote irrespective of the amount of his individual investment. The principle of one vote per member, which appears in the legislation of every province, reflects the social nature of a co-operative as an association of persons rather than a business unit in which control is determined by capital investment. As a corollary to this principle all provincial Acts prohibit, with one narrow exception in British Columbia, voting by proxy. The relevant provisions of the Ontario Act are found in section 130, which provides:

> "130(1) No individual member or shareholder of a corporation shall vote by proxy.
>
> (2) An individual member or shareholder of a corporation has only one vote.
>
> (3) A corporate member or shareholder may appoint under its corporate seal one of its directors or officers to attend and vote on its behalf at meetings of members or shareholders and such director or officer has only one vote.".

2. Some doubts have been expressed whether democratic control, which was the aim of the Rochdale Pioneers,[1] is best implemented today by the "one member, one vote" principle.[2] While it is generally accepted that control should be separated from investment, it has been questioned whether it is really democratic for a co-operative, which exists to serve its members as patrons rather than as investors, to permit members who do no business with the co-operative to vote on its policies or elect its directors. The controversy surrounding the meaning of democratic control was recognized by the International Co-operative Alliance in the 1966 Reformulation of the Essential Principles of Co-operation which stated:

> "Members of primary societies should enjoy equal rights of voting (one member one vote) and participation in decisions affecting their societies . . ."

but added,

> "In other than primary societies the administration should be conducted on a democratic basis in suitable form.".

3. A number of the State Acts permit primary co-operative associations to weight the voting rights of members according to their patronage with the co-operative in a given period, presumably on the basis that this represents a more equitable method of representation in keeping with the concept of a co-operative as an association for member patrons.[3] One provincial Act permits a co-operative to disenfranchise a member who has done less than the minimum amount of business stipulated in the by-laws of the co-operative[4] and failure to transact any business with the co-operative for a period of two years is a ground for expulsion under the Ontario Act.[5]

4. No submissions were made to the Committee that the one member, one vote principle, as it applies to co-operatives in Ontario, should be changed nor is the Committee of the view that any change should or need be made. This method of voting has been a cornerstone of the co-operative movement for many years and the Committee is not persuaded that any of the alternatives considered would offer a more effective means of ensuring democratic control.

5. In some jurisdictions a limit is placed on the maximum size of a member's investment in a co-operative on the basis that even without additional voting power undue influence might conceivably be brought to bear on the administration of a co-operative by reason of a large investment. The restriction is usually in terms of a maximum percentage of the outstanding equity or a limit on the monetary value of the investment.[6] The Committee does not recommend that such a restriction be imposed on members of co-operatives in Ontario. The power of a member with a large investment in the co-operative to influence its affairs is related to his ability to withdraw and realize his investment to the possible detriment of the co-operative and the Committee has recommended certain limitations upon the power in a member to recover the whole of his investment upon withdrawal from a co-operative, should its financial stability be thereby threatened.

6. A limitation on the amount of a member's investment could also impede the operation of a revolving capital or loan fund and prevent a co-operative from securing finance from its membership in this manner. It would also appear to conflict with what is recognized as a general obligation, if not yet classified as a co-operative principle, that a member is expected to contribute to the financing of a co-operative in proportion to his use of the services of the co-operative.

7. The general prohibition on the right to vote by proxy is probably satisfactory in the case of a small co-operative operating in a local area, the members of which are for the most part active in the affairs of the co-operative and able to attend meetings. However, in larger co-operatives with dispersed memberships, it becomes more difficult to engender member

participation and some members may be unable to attend meetings of the co-operative because of the distance or expense involved. In the absence of some other representative method of voting, the prohibition on voting by proxy could effectively deprive a number of members of a right to vote and to participate in the affairs of the co-operative which could result in the co-operative being controlled by a small group of members, thus undermining the principle of democratic control which the prohibition on proxies is designed to further.

8. In apparent recognition of this difficulty, section 137 of the Act permits a co-operative to pass by-laws which have the effect of setting up a delegate system of voting. Section 137 provides as follows:

"137.—(1) A corporation may pass by-laws providing for,

(*a*) the division of its members or shareholders into groups, either territorially or on the basis of common interest;

(*b*) the election of some or all of its directors,

(i) by such groups on the basis of the number of members or shareholders in each group or the volume of business done by each group with the corporation, or both, or

(ii) for the groups in a defined geographical area, by the delegates of such groups meeting together;

(*c*) the election of delegates and alternative delegates to represent each group on the basis of the number of members or shareholders in each group or the volume of business done by each group with the corporation, or both;

(*d*) where all of the members or shareholders are corporations, the election of delegates and alternative delegates to represent such corporations on the basis of the number of members or shareholders in each corporation or the volume of business done with each corporation, or both;

(*e*) the number and method of electing delegates;

(*f*) the holding of meetings of delegates;

(*g*) the authority of delegates at meetings or providing that a meeting of delegates shall for all purposes be deemed to be and to have all the powers of a meeting of the members or shareholders;

(*h*) the holding of meetings of members, shareholders or delegates territorially or on the basis of common interest;

(*i*) the payment of expenses of delegates attending meetings.

(2) A delegate has only one vote and shall not vote by proxy.

(3) No person shall be elected a delegate who is not a member or shareholder of the corporation or a director, officer, member or shareholder of a corporate member or shareholder of the corporation.

(4) No such by-law shall prohibit members or shareholders from attending meetings of delegates and participating in the discussions at such meetings.".

As the Committee understands the mechanics of the delegate system, the membership of the co-operative is divided into zones or branches, and the members of each zone or branch are entitled to elect a specified number of delegates to attend meetings. The number of delegates which a zone or branch is entitled to elect may depend on either the number of members in each zone or branch or the volume of business transacted with the co-operative by the members of the zone or branch or both. Zone or branch meetings are held at which the members of the zone or branch elect their delegates to attend meetings of shareholders and at which the affairs of the co-operative are discussed. In effect, a zone or branch meeting is more or less the equivalent of a local annual meeting.

9. The delegate system has been adopted by several large co-operatives in Ontario. It mitigates some of the possible hardships resulting from the prohibition on the use of proxies in the case of co-operatives with a widely dispersed membership, but it is open to question whether it is strictly in accordance with the principle of one member, one vote, for in a delegate system of voting the member is entitled to vote only in a particular zone or branch for the election of delegates and, although the member has a statutory right to attend and participate in a general meeting of the co-operative, only the duly elected delegates have the right to vote. It might seem more appropriate to the democratic nature of a co-operative to permit the members residing beyond a certain distance from the place of the general meeting to vote by proxy as in one provincial Act,[7] and to prohibit group or delegate voting, on the basis that the direct election of directors by vote of the members in general meeting exercisable in person or by proxy is preferable to their indirect election by a tiered system of delegate representation. However, the Committee is advised that the principle of delegate voting in co-operatives is widely accepted in Ontario and elsewhere, has worked satisfactorily and that there would be opposition within the co-operative movement to permitting the use of proxies, which it is thought would tend to entrench management. The Committee is therefore not prepared to recommend at this time the right to vote by proxy.

10. The Committee also considered whether the volume of business transacted by the members of a zone or branch should be a relevant factor to take into account in determining the number of delegates of such zone or branch as an alternative to delegate representation based upon the number of members in each zone or branch. If the number of delegates is

determined by a combination of size of membership and volume of business or by volume of business alone, the situation could result in members of two different zones of approximately the same size being entitled to a different number of delegates by reason of the fact that the members of one zone may have transacted substantially more business than the members of the other zone. This would further tend to derogate from the principle of one member, one vote. However, it was submitted to the Committee that an active membership should be promoted and encouraged and that the volume of business done by the members of a zone should therefore be a permissible criterion for determining the number of delegates it might elect to represent its members at meetings of members. The Committee is satisfied that the present system of delegate voting employed by larger co-operatives operates in a satisfactory manner. It does in fact provide a method of member participation through local zone meetings which would otherwise be lacking. The Committee accordingly recommends that no changes be made in the provisions of the Act relating to delegate voting.

12. **The Committee therefore recommends** that:

(a) no change be made in the principle of one member, one vote as presently incorporated in the legislation;

(b) the provision preventing voting by proxy be continued;

(c) no change be made in the present provisions of the legislation with respect to delegate voting;

(d) no limit be imposed on the size of a member's investment in a co-operative.

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1. According to Holyoake, *History of the Rochdale Pioneers* (1907), the principle was stated as "Democratic control (one member, one vote)."
2. It has been suggested that the one man one vote principle should apply only where the members are economically equal and that where such equality does not exist proportional voting based on patronage would be more equitable.

> "Cooperators vote equally in their associations because they are, for all practical purposes, economically equal, not because they strive for economic equality. There cannot be a more striking and persuasive illustration of this fact than the very case of the Rochdale Pioneers themselves, who were perfectly equal . . . in their poverty."

I. Emelianoff, *Economic Theory of Cooperation*, (1942), pp. 195-196.

3. *E.g.* New York Cooperative Corporations Law, N.Y.C.L. c.77§12. According to Roy, *Cooperatives: Today and Tomorrow*, (2nd ed. 1969) p. 203, 18 States permit voting on a basis other than one man one vote.
4. See Alberta Act, s.18(5)(d) which permits a co-operative to enact supplemental by-laws providing that a member is not entitled to vote at meetings of an association, or act as a delegate thereat, unless he has during the preceding financial year purchased goods or obtained services or marketed products from or through the association of such value as shall be stated in the by-laws.
5. Section 135(1)(b), applicable only to co-operatives with share capital.

6. Alberta Act, s.19(8) which provides:

   "s.19(8) No member is entitled to hold, directly or indirectly, more than ten per cent of the total issued share capital of the association."

   In Manitoba, "No member shall hold more than one-twentieth of the total number of common shares of share capital comprised in the capital of the corporation . . ." Manitoba Act, s.419.

   In England, The Industrial and Provident Societies Act, 1965 (13 & 14 Eliz. II) c.12, s.6. limits maximum shareholdings of an individual in a registered co-operative to £1,000.

7. British Columbia Act, s.24(3).

CHAPTER 13

Membership

General Matters

1. The Act is silent on the age at which a person may become a member of a co-operative. Most provinces provide that only persons of 16 years[1] or over may be admitted as members and in one province the minimum age for membership is 21.[2] The Committee is of the opinion that the Ontario Act should recognize the right of a minor 16 years of age or over to be admitted as a member of a co-operative with all of the benefits and obligations which go with membership. The Act should further provide that any person under the age of 21 years admitted to membership is competent to enter into any contract with the co-operative and with respect to contracts with the co-operative is sui juris.

2. The minimum number of members which a co-operative must have under the present Act is three.[3] Although section 135(2) presently provides that a co-operative may not purchase shares for redemption so as to reduce the number of shareholders to fewer than ten, this does not in the opinion of the Committee fix the minimum number of members at this figure. Since the Committee has recommended that a co-operative shall have at least five directors and that a director must be a member of the co-operative,[4] the minimum number of members would automatically be increased to five. Although arguments can be made that a successful co-operative should have more than five members, the Committee considers no useful purpose would be served by selecting some arbitrary minimum number of members which a co-operative must have beyond the minimum of five required as directors.

3. The Business Corporations Act has accorded to minority shareholders of a business corporation greater rights with respect to instituting actions against the corporation, requisitioning meetings and other matters. The Committee considers the additional rights available to shareholders of a business corporation should also be accorded to the members of a co-operative. The Committee therefore recommends that the legislation relating to co-operatives contain provisions substantially similar to those of sections 99, 101, 102, 109 and 110 of The Business Corporations Act which for convenient reference are set out in Appendix C.

4. **The Committee therefore recommends** that:

   (a) the legislation recognize the right of a minor 16 years or over to be admitted as a member of a co-operative;

   (b) the legislation provide that the contracts of a minor with his co-operative be valid as if he were sui juris;

(c) the minimum number of members of a co-operative be fixed at five;

(d) the legislation relating to co-operatives contain provisions substantially similar to sections 99, 101, 102, 109 and 110 of The Business Corporations Act.

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1. Alberta, British Columbia, Newfoundland, Prince Edward Island, Quebec and Saskatchewan.
2. New Brunswick, subject to any contrary provision in the supplemental by-laws. The Manitoba Act also stipulates 21 as the minimum age for membership, but is overridden by the statute which recently lowered the age of majority in that province to 18 years.
3. Section 332(1).
4. Chapter 15, *infra*.

CHAPTER 14

Interest on Capital

1. It is a basic tenet of co-operative philosophy that the beneficiaries of a co-operative enterprise should be the patrons and not absentee investors. One co-operative principle intended to accomplish this result is that capital should receive only a strictly limited return, which requires for its realistic application the achievement of a balance between a return low enough to discourage those seeking only investment income from joining the co-operative, but high enough to meet the commercial necessity of enabling a co-operative to raise sufficient finance from its membership or from outside sources in order to provide a satisfactory service.

2. Under the present Act, co-operatives with share capital may pay dividends on shares up to a maximum rate of 8% per annum[1] while co-operatives without share capital may pay such rate of interest on member loans as the by-laws provide.[2] Although dividends represent a distribution from surplus whereas interest constitutes an expense incurred in earning surplus, this distinction is less important in co-operatives than in standard business corporations. Both represent a return on capital which as a matter of co-operative philosophy should be strictly limited.

3. Between 1917 and 1949 all co-operatives, whether organized with or without share capital, were subject to the same limit on interest or return on capital of 8% per annum. In the 1949 revision of the co-operative Part, the 8% ceiling on dividends was retained, but the maximum permitted rate of interest on member loans was reduced from 8% per annum to 6% per annum. The amendment in 1949 thus created an inconsistency favouring co-operatives with share capital which were permitted to pay a higher return by way of dividends than co-operatives without share capital could pay by way of interest on member loans. The amendment in 1968 which enacted section 127 of the present Act removed the inconsistency in favour of co-operatives with share capital by eliminating the interest ceiling on member loans, thereby creating an inconsistency favouring co-operatives without share capital.

4. The present situation is unsatisfactory and is illustrative of the many unjustifiable distinctions between provisions governing co-operatives with share capital and those without share capital. It would seem to the Committee essential to ensure a substantial degree of consistency between the provisions regulating the rate of return on capital of co-operatives with share capital and without share capital particularly in view of the ease with which the statutory ceiling on dividends can be avoided by limiting the issue of shares for the purpose of obtaining membership in the co-operative and relying on debentures or loans for the purpose of raising finance and which are subject to no statutory interest ceiling.

5. A submission was received advocating the removal of the 8% ceiling on dividends pointing out the discrepancy already noted and suggesting that, while most co-operatives rarely pay dividends as high as 8%, they should be permitted to pay a higher rate if they wish. One group of co-operatives particularly affected by the dividend ceiling are those co-operatives which, as a result of marketing board legislation, are no longer able to deal directly with their members and are thus prevented from making any distributions by way of patronage returns.[3] The only means of distributing the surplus accumulated by those co-operatives is by declaration of dividend and in some cases the 8% ceiling is insufficient to use up the available surplus forcing such co-operatives to allocate the remainder to a reserve.

6. Only two provincial Acts contain no limit on the maximum return on capital payable by a co-operative[4] and the ceiling in other provinces ranges from 5% in Alberta and Saskatchewan to 7% in Manitoba, Prince Edward Island and Newfoundland and 8% in British Columbia.[5]

7. It appeared to the Committee that to remove the ceiling on dividends would be to eliminate entirely a basic co-operative principle already undermined by inconsistencies in the legislation, a recommendation which would not be favoured by a large part of the co-operative movement and one that the Committee would be reluctant to make in the absence of any compelling reason. The predicament of certain co-operatives affected by marketing board legislation is perhaps best resolved by special legislation dealing with their specific situation.

8. In the view of the Committee a distinction should be made, for the purpose of imposing a ceiling on the return on capital, between those funds invested in the co-operative as a condition of membership and other funds representing additional voluntary investments by the members.

9. The former would include qualifying member loans and patronage rebates retained as compulsory loans in a co-operative without share capital, which are presently subject to no ceiling on the rate of interest payable, and qualifying shares and patronage rebates compulsorily applied to the purchase of shares in a co-operative with share capital, which are subject to a ceiling on dividends of 8% per annum. These are "captive funds" which represent a member's obligatory contribution to the capital of the co-operative and should be subject to an identical limited return. The Committee therefore recommends that the dividend ceiling of 8% be retained on the ordinary shares of a co-operative and on any shares issued from retained patronage, and that an interest ceiling of 8% be imposed on qualifying member loans in a co-operative without share capital and on compulsory patronage loans retained by any co-operative.

10. It is unrealistic to expect members, except perhaps dedicated co-operators, voluntarily to invest additional funds in the co-operative at a

rate of interest lower than the prevailing market rate for investments involving a comparable degree of risk. Such funds should therefore be regarded for the purpose of the permissible rate of return as equivalent to funds raised from sources outside the membership and should not be subject to any arbitrary ceiling which if less than the prevailing market rate would unfairly handicap a co-operative. The Committee therefore recommends that member loans invested voluntarily and in addition to the investment required as a condition of membership should remain free of any ceiling on the permissible rate of interest.

11. It was submitted to the Committee that the provision which requires that the rate of interest payable on such loans be fixed by by-law is unsatisfactory since it appears that the actual rate must be stated in the by-law. It was submitted to the Committee that this procedure is too inflexible to permit frequent adjustments to meet changing market conditions. The Committee recommends that, if authorized by by-law, the board of directors be permitted to determine from time to time by resolution the appropriate rate of interest on additional voluntary loans from members.

12. **The Committee therefore recommends** that:

(a) the present limitation on dividends payable by a co-operative with share capital be retained;

(b) the interest rate payable on loans made to a co-operative without share capital as a condition of membership be limited to 8% per annum;

(c) the interest rate payable on compulsory loans of patronage returns be limited to 8% per annum;

(d) the interest rate payable on loans, not representing loans made as a condition of membership or as compulsory loans of patronage returns, be not limited in the legislation;

(e) the legislation provide that the board of directors, if authorized by by-law, be permitted to determine the rate of interest payable on loans, subject to the limitations expressed in clauses (b) and (c) above.

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1. Section 132.
2. Section 127.
3. See further Chapter 23, *infra*.
4. New Brunswick and Nova Scotia.
5. In the recently enacted Canada Co-operative Associations Act, the maximum permitted rate of interest or dividends would appear to be subject to the approval of the Minister. (ss.3(1)(d); 11(2)(a), (b), (c) and (d)).

CHAPTER 15

Directors and Officers

1. In the virtual absence of special provisions in Part V of the Act relating to the qualification, minimum number, tenure, powers and duties of directors and officers of co-operative corporations and the rights of aggrieved members to intervene in the affairs of their co-operative, the general provisions of the Act apply to co-operative corporations. The relevant legislation was critically examined by this Committee in its Interim Report and a number of changes were recommended, many of which have since been implemented as a result of the enactment of The Business Corporations Act.

2. In many respects, the internal administration of a co-operative and a business corporation are basically similar, notwithstanding significant philosophical differences. In examining the provisions relating to the directors and officers of a co-operative, the Committee was of the opinion that there were two main questions for consideration; firstly, having regard to the legislation of other provinces and the concept of a co-operative, to what extent the present provisions of the Act require modification and, secondly, in those areas where the legislation has hitherto been identical with that applicable to the business corporation, the extent to which the recommendations of this Committee in its Interim Report should be extended to co-operatives.

3. Section 296(1) of the Act provides:

> "296(1) The affairs of every corporation shall be managed by a board of directors howsoever designated.".

The Committee noted in its Interim Report that this section does not accurately reflect the varied and changing role of the board of directors in the modern corporation and recommended that section 296(1) be amended to provide that the affairs of a corporation be managed or supervised by a board of directors howsoever designated,[1] a recommendation which has since been embodied in section 132(1) of The Business Corporations Act. This recommendation appeared to the Committee to be equally valid in the case of a co-operative where the role of the director is perhaps more often of a supervisory nature with greater reliance on management employees than is usually the case in an ordinary business corporation of similar size. This is particularly true of agricultural co-operatives where members are independent producers primarily concerned with their own farming interests which the co-operative is organized to serve. The Committee therefore recommends that the role of the board of directors be defined as "to manage or supervise the affairs of the co-operative corporation".

4. Under the Act, the board of directors of a co-operative must consist of not fewer than three directors[2] elected by the members in general meeting for a term not exceeding five years in such manner and upon such conditions as the by-laws provide.[3] Each director must be a member of the co-operative at all times without the benefit of the ten days grace in which to become a member available to directors of ordinary corporations,[4] at least 21 years of age[5] and may not be an undischarged bankrupt.[6]

5. In the Interim Report the Committee recommended that the statutory minimum number of directors should in most cases be reduced to one and section 122(2) of The Business Corporations Act gives effect to that recommendation. The concept of the "one-man" company should not be extended to a co-operative since it is inconceivable to the Committee that a true co-operative could operate with only one shareholder or member. A successful co-operative depends on member participation, not only in its business but in its administration and the Committee is concerned that the present statutory minimum of three directors is too low for this purpose. To foster member participation, at least in administrative matters, the Committee is of the view that the minimum number of directors of a co-operative should be increased to five, a minimum which accords with the equivalent requirements of several provincial Acts. In recognition that there may presently exist co-operatives operating with less than five directors, the Committee recommends as a transitional measure that such co-operatives be permitted to continue with fewer than five directors for a period of two years but thereafter be required to increase their number of directors to five.

6. The Committee in its Interim Report expressed the opinion that the provisions of sections 299(1), (2) and (3) of the Act served no useful purpose and should be repealed,[7] a recommendation which has been implemented in The Business Corporations Act with the effect that a director of a business corporation need not be a shareholder.[8] It seemed obvious to the Committee that, consistent with basic co-operative principles, a director of a co-operative must be a member or shareholder of the co-operative. The Committee therefore recommends that the provisions of section 131 be retained. In the view of the Committee there is no need to extend the exception presently contained in section 299(2) to co-operatives; a director of a co-operative should be a member or shareholder prior to his election. In addition to requiring a director to be a member or shareholder of the co-operative, the Committee considered whether a director should be required to conduct a minimum amount of business with the co-operative in order to qualify for or maintain office. The Committee concluded that while a director should be a member or shareholder at all times as a condition of eligibility, the Act should not impose as a mandatory additional qualification that he be an active patron conducting a minimum

annual amount of business with the co-operative, although the Act should enable a co-operative to impose such a requirement by by-law if it so wishes.[9] While it is no doubt generally desirable that the directors be elected from among the active patrons, the members might wish to elect to the board of directors a retired member who no longer deals actively with the co-operative, but whose experience and available time are considered valuable to the co-operative.

7. Although there is at present no statutory minimum age qualification for membership in a co-operative, a member is required to be at least 21 years in order to be eligible to be a director. The Committee is advised that the present minimum age requirement can cause some hardship to co-operatives organized among students. One provincial Act expressly permits persons of 18 years and over to be directors[10] and in most provinces the age of majority has been reduced from 21 to 18 years.[11] The Committee has recommended that the minimum age for membership in a co-operative be fixed at 16 years,[12] and following a similar recommendation made by the Committee in its Report on Credit Unions recommends that members of 18 years and over be eligible to be elected as directors and to serve as officers.[13]

8. Section 64(1) of the Act which permits cumulative voting for the election of directors under the circumstances outlined in that section is not, by reason of section 64(2), applicable to co-operatives, possibly on the theory that to permit a member to cumulate his votes and cast them all for one member would, in effect, give that member more than one vote in breach of the co-operative principle of one member, one vote. The Committee is advised that a common practice among co-operatives in the election of directors is to require members to vote for a candidate for each vacancy on the board and that failure to vote for a complete slate invalidates the ballot. It seemed to the Committee that this practice is conducive to democratic control in a co-operative and should be embodied in the Act as a requirement for all co-operatives. For similar reasons the Committee considered that the current prohibition on cumulative voting should be retained.

9. The Act is silent as to the minimum standard of care a director is required to observe in the exercise of his duties to the corporation. In the absence of direct authority as to standard of care owed by directors of co-operative corporations it is generally considered that the required standard is identical with that required of directors of an ordinary business corporation under the common law. Because of the substantially similar roles and responsibilities of the director of a co-operative and the director of a business corporation, the Committee recommends that the standard of care of a director of a co-operative be the same as the standard of care imposed on the director of a business corporation by section 144

of The Business Corporations Act. Since this section also extends the standard of care to officers, the Committee also recommends that officers of a co-operative be made subject to the same standard of care.

10. Directors of co-operatives in common with other corporations governed by the Act are permitted by section 70 to enter into binding contracts with the co-operative provided notice declaring their direct or indirect interest in the contract or proposed contract with the co-operative is given either to the board of directors or to the shareholders in general meeting. If the declaration of interest is made to the board, the interested director may not vote in connection with the contract or proposed contract. The intention of section 70 is to abrogate the strict common law rule which renders any contract between a company and a director, except a contract of service, voidable by the company by reason only of the director's interest. In doing so it seeks to prevent directors from misusing their position as insiders by requiring them to disclose their interests so that any personal advantage accruing to the director from a contract may weigh as a factor in the decision of the board. The rationale underlying section 70 is, however, not applicable with equal force to co-operative corporations since directors of a co-operative are usually active patron members of the co-operative and are expected to transact active business with the co-operative which may necessitate the entering into of standard form contracts. This is particularly so in the case of a marketing co-operative. The effect of section 70 is therefore to require disclosure of any interest in ordinary contracts made by a director of a co-operative, *qua* member, in the normal course of dealings with the co-operative or risk their rescission. It appeared to the Committee that section 70 in its broad application is thus inappropriate to co-operative corporations. Most provincial Acts are silent in regard to the enforceability of contracts made between directors and their co-operatives leaving the matter to be governed either by common law or the provisions of the relevant Companies Act where applicable. One province expressly prohibits a director from being a party to any contract for profit with his co-operative (with an exception for service contracts) which would confer benefits on that director not generally available to other members.[14] In the opinion of this Committee, such a provision unduly penalizes a director of a co-operative whose power to contract with the co-operative should not differ in any substantial measure from that of a director of a business corporation. What is required, in the opinion of the Committee, is a provision in the legislation which would enable directors to patronize the co-operative of which they are members without the need to declare their interests in standard or ordinary contracts available to all members, while requiring disclosure of their interest in any unusual, material contract, proposed contract or transaction with the co-operative. Where disclosure is required, the nature and extent of the disclosure should be that provided in section

134 of The Business Corporations Act. In making this recommendation the Committee is aware of the difficulties that are sometimes involved in determining what constitutes a standard or ordinary contract but this is a matter which should be clear in the majority of cases. In any instance where doubt might arise, the problem should be resolved by a disclosure of interest on the part of the director.

11. Section 71 of the Act requires insiders of a public company with 15 or more shareholders to file with the Ontario Securities Commission certain reports as to their direct or indirect beneficial ownership of securities of the company and imposes a liability on an insider who in connection with a transaction relating to securities of the company, makes use of specific confidential information for his own benefit or advantage that, if generally known, might reasonably be expected to affect materially the value of such securities. The provisions of section 71 are applicable to co-operatives with share capital but would not appear to be applicable to co-operatives without share capital since the definition of the term "company" as used in section 71 means a corporation with share capital. There are in the opinion of the Committee, several reasons why the requirement to file insider reports should not extend to the insiders of a co-operative.

12. A member of a co-operative has only one vote regardless of the number of shares he owns so that the holder of 10% of the voting shares in a co-operative is no more able to influence the conduct of the affairs of the co-operative by his voting powers than a member with only one share.

13. Shares in a co-operative do not fluctuate greatly in value, are subject to a dividend limit of 8% per annum, may be repurchased or redeemed by a co-operative incorporated under Part V at a maximum of par value, and transfers of shares require the approval of the board of directors. All these factors contribute to the absence of any significant market in the shares of a co-operative.

14. There would nevertheless appear to be certain opportunities for abuse of confidential information by insiders of a co-operative for their personal gain. In particular, the judicious exercise of the discretion to approve transfers of shares and the selective use of the power of a co-operative to purchase its shares might enable the directors to dispose of their shares in favourable circumstances or, as appears to have occurred in one case, to reduce the number of members and thereby acquire effective control of a co-operative with valuable capital assets in order to wind up the co-operative and divide the assets. For this reason, the Committee, while recommending the elimination of a requirement that insiders of a co-operative with share capital file insider reports, recommends that insiders of all co-operatives, defined as directors and officers, their associates and affiliates, be liable to compensate any person for any direct loss resulting from the use of any specific confidential information in connection

with a transaction relating to the securities of the co-operative and accountable to the co-operative for any direct benefit or advantage resulting therefrom under a provision of the legislation modelled on section 71d of the Act.

15. Under section 66 of The Corporations Act, the letters patent, supplementary letters patent or by-laws of a co-operative may provide that the members may, by a resolution passed by at least two-thirds of the votes cast at a general meeting of which notice specifying the intention to pass such resolution has been given, remove any director before the expiration of his term of office. The Committee recommended in the Interim Report that shareholders should have the right, by a simple majority vote, to remove a director and considers that members of co-operatives, both with and without share capital, should have a similar right. Accordingly, the Committee recommends that the legislation respecting co-operatives contain provisions substantially similar to those of section 140 of The Business Corporations Act.

16. **The Committee therefore recommends** that:

(a) the role of the board of directors of a co-operative be defined in the legislation as to manage or supervise the affairs of the co-operative;

(b) the minimum number of directors of a co-operative be fixed at five;

(c) co-operatives which at present have a board of less than five be permitted to continue with less than five directors for a period of two years but thereafter be required to increase their number of directors to five;

(d) a director of a co-operative be a member or shareholder, as the case may be, of the co-operative at the time of his election and throughout his term of office;

(e) a co-operative be permitted, by by-law, to require a director to conduct a minimum annual volume of business with the co-operative as a condition of eligibility;

(f) members of the age of 18 years and over be eligible to be elected directors of a co-operative and to hold office;

(g) members be required to cast a vote for a full slate of directors and the present prohibition on cumulative voting for the election of directors be retained;

(h) the standard of care, diligence and skill imposed on directors and officers of a business corporation by section 144 of The Business Corporations Act be made applicable to directors and officers of a co-operative;

(i) except in respect of standard and ordinary contracts available to all members, a director of a co-operative be required to disclose his interest and refrain from voting in respect of any contract, proposed contract or transaction with the co-operative;

(j) in cases where a director of a co-operative is required to disclose his interest in a contract, proposed contract or transaction with his co-operative, the nature and extent of the disclosure should be identical with that required by section 134 of The Business Corporations Act;

(k) insiders of a co-operative not be required to file insider trading reports;

(l) directors and officers, their associates and affiliates, be subject to the liabilities imposed on insiders under section 71d of the Act;

(m) a director be subject to removal before the expiration of his term of office by resolution passed by a majority vote of the members at a general meeting.

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1. Interim Report, Chapter VII.
2. Section 296(2).
3. Section 300.
4. Section 131 which would appear to override Section 299(2).
5. Section 299(4).
6. Section 299(5).
7. Interim Report Chapter I.
8. The Business Corporations Act, 1970, S.O. 1970, c. 25, s.125.
9. See Alberta Act, s.26(5).
   Prince Edward Island Act, s.27.
   New Brunswick Act, s.36.
   Saskatchewan Act, s.72. (consumer co-operatives only).
10. Newfoundland Co-operative Societies (Amendment) Act, S.N. 1963.
11. In all provinces except New Brunswick and Ontario, the age of majority is presently 18.
12. Chapter 13, *supra*.
13. Report on Credit Unions 1969, Chapter 11.
14. Manitoba Act, s.411.

CHAPTER 16

Revolving Fund

1. Co-operatives raise finance from a number of sources both within and outside the membership.[1] One method of financing developed by co-operatives particularly suited to their mutual character and the special nature of co-operative capital is the revolving fund which, in the case of all co-operatives, may take the form of a revolving loan fund and, in the case of co-operatives with share capital, a revolving stock fund.[2]

2. Co-operatives are required to return to the members any surplus resulting from the operation of the co-operative, after due provision for reserves and interest on capital, in the form of patronage rebates, but section 133(1) of the Act, which embodies this fundamental co-operative principle, requires that the surplus be "allocated, credited, or paid" to the members and therefore not necessarily distributed in cash.

3. Pursuant to section 134(4), a co-operative may enact a by-law empowering the board of directors to retain the whole or any part of the patronage rebate due to a member as a compulsory loan to the co-operative. Most co-operatives have enacted an appropriate by-law which, in conjunction with sections 133 and 134(4), is sufficient to enable a co-operative to establish a revolving loan fund. Annual patronage rebates are credited to the members in accordance with section 133 and retained by the co-operative pursuant to section 134(4) as compulsory loans. When the accumulated patronage loans are sufficient to meet the needs of the co-operative, the fund is maintained at that level by continuing to withhold current patronage rebates which are used to retire, in chronological order, patronage loans retained by the co-operative in earlier years. The typical by-law empowers a co-operative to retain patronage loans for a maximum term of 20 years, but they are generally revolved within a period of eight to ten years. The repayment of such loans before maturity is, however, a matter within the discretion of the directors. Since the amount of patronage rebate allocated to a member and retained by the co-operative as a compulsory loan is related directly to the volume of business transacted with the co-operative, the revolving fund method of raising finance embodies the co-operative precept that members should contribute to the financing of the co-operative in proportion to the benefit they derive from its services.[3]

4. Patronage loans constitute a fixed obligation of the co-operative sometimes bearing interest, and always subject to a date of maturity requiring a co-operative to realize an annual surplus sufficient not only to meet financing charges but also to repay patronage loans as they fall due. The revolving loan scheme therefore entails possible hazards to declining

co-operatives, those in which the rate of annual surplus tends to fluctuate and to newly formed co-operatives if burdened by interest charges during their early years when earnings are usually small.

5. Such disadvantages inherent in a revolving loan fund may be avoided by co-operatives with share capital through the establishment of a revolving stock fund. This is in part accomplished by section 134 (1) which permits a co-operative with share capital to enact a by-law empowering the directors to apply patronage returns due to a member towards the purchase of shares in the co-operative. In this way patronage returns which constitute a fixed liability to members are transferred into risk capital thereby lowering the debt of the co-operative.

6. In principle there should be no greater restrictions upon the operation of a revolving stock fund than on a revolving loan fund, particularly if due regard is had to the special nature of co-operative shares.[4] Although the Act makes no terminological distinction, the so-called shares of a co-operative resemble loans rather than shares of a typical business corporation. Stemming from the fundamental characteristic that a co-operative is composed of a group of member patrons rather than investors, shares in a co-operative are viewed as temporary investments of the member representing his equitable contribution towards the capital sum needed to enable the co-operative to provide the goods and services for which it is organized. This contribution is to be retained by the co-operative only so long as the member chooses or is able to make use of its services, and returned to the member during the currency of his membership if and when subsequent contributions to the capital of the co-operative render his earlier investment unnecessary to finance its facilities.[5]. But the operation of a revolving stock fund presupposes the ability of a co-operative with share capital to repurchase shares issued in lieu of cash patronage returns and since co-operatives with share capital are "companies" they are subject to the common law prohibition upon the repurchase by a company of its own shares.[6] The operation of a revolving stock fund is therefore dependent upon the existence of a specific statutory provision overriding the common law rule.

7. Until 1949 it was not possible for co-operatives with share capital in Ontario to operate a revolving stock fund because the Act contained no provision permitting a co-operative with share capital to repurchase its own shares.

8. In the 1949 revision of the co-operative Part some recognition was given to the special nature of the share capital of a co-operative by the enactment of what is presently section 135 of Part V empowering a co-operative to repurchase its own shares. However, stemming perhaps from a reluctance to depart from a long standing common law prohibition,

section 135 is hedged with restrictions that, in the opinion of this Committee, handicap without justification the operation of a revolving stock fund and seriously affect the efficacy of what is a most desirable method of raising finance.

9. Section 135(2) (a) of the Act provides that no company,

> "shall use for the purchase of shares for redemption in a fiscal year an amount in excess of 50 per cent of the accumulated reserve funds;".

The precise meaning of this provision is unclear. Section 135(2)(a) does not in its literal terms stipulate that only the accumulated reserve fund may be used by a co-operative for the repurchase of its share but does limit the amount which may be expended for such purpose to 50% of the accumulated reserve fund. Interpreted in this manner, the accumulated reserve fund is the yardstick rather than the source of funds which may be used for the repurchase by a co-operative of its shares. However, according to the interpretation accepted by the co-operative movement, the accumulated reserve fund is under section 135(2)(a) both the source and measure of the funds which a co-operative may use to purchase its own shares.

10. While there may be some doubt as to the intent of the provision, its indirect effect is to require those co-operatives with share capital wishing to raise finance by means of the revolving stock fund to establish and maintain reserve funds. Most co-operatives in Ontario allocate a portion of their annual surplus to reserves as a matter of prudent business practice but unlike the legislation of some provinces[7] the Act has never imposed as a mandatory requirement the maintenance of a minimum reserve fund. In the view of the Committee, the establishment and size of a reserve fund by any co-operative is a business decision for the management of the co-operative which should not be within the province of legislative control. The power of a co-operative to repurchase its shares should not, in the view of the Committee, be related to the existence or sufficiency of any reserve fund.

11. The recently enacted federal Act recognizes the basic differences between the temporary nature of share capital of a co-operative and the more permanent nature of equity in the business corporation and expressly empowers co-operatives to use any source of funds, including capital, for the repurchase of its shares.[8] In addition to deleting the restriction limiting the repurchase of shares to a percentage of surplus, the Committee recommends that section 135(2)(a) be amended to provide explicitly that co-operatives be empowered to use capital for the purchase of its shares.

12. Under section 135(2)(b) a co-operative may not repurchase in any year more than 10% of its outstanding shares. The Committee has been unable to ascertain any reasons for this restriction except perhaps a possible reluctance in 1949 to breach the rule against the repurchase of shares beyond what seemed absolutely necessary at that time to accommodate co-operatives. The selection of an arbitrary percentage is an undesirable limitation which may not correspond with the needs of a particular co-operative and should, in the opinion of the Committee, be removed.

13. The Committee agrees with the general requirement in section 135(2)(c) that a co-operative with share capital be solvent as a condition for the repurchase of any of its shares. However, section 135(2)(c) also prohibits the repurchase of shares if the effect would be to reduce the number of members below 10, and this would appear to be less sound in concept. It is somewhat difficult to appreciate why a co-operative with share capital should be prevented from reducing its membership below 10 for the purpose of repurchasing its shares, but is permitted to approve transfers of shares provided only that the membership is maintained at a minimum of three as required by section 322. The Committee has recommended in Chapter 15 that a co-operative be required to have five directors all of whom must be members, which in effect fixes the minimum membership of a co-operative at five. A co-operative with share capital should be empowered to repurchase the shares of a member provided the membership does not fall below five.

14. A further difficulty arises from the provision that a co-operative may purchase its shares only for redemption and cancellation. The effect of this provision is that a co-operative with share capital operating a revolving stock fund may have to increase its capital periodically as shares are purchased and cancelled. This requires an application for supplementary letters patent and can, therefore, be a cumbersome and expensive procedure. Co-operatives with share capital should be empowered to repurchase shares for later resale or cancellation in the discretion of the directors of the co-operative, as is presently permitted under The Business Corporations Act where a corporation purchases its common shares.

15. One provision designed to safeguard the rights of outside creditors by relegating patronage loans to the status of ordinary capital in the order of priority for payment of a co-operative's debts is too narrow in its present application. Section 136(1) provides:

> "136(1) On any distribution of the property of a corporation without share capital, member loans and patronage returns that are lent to the corporation rank after the ordinary debts.".

It will be seen that section 136(1) applies only to the patronage loans of co-operatives without share capital. Co-operatives with share capital can

choose between a revolving stock fund and a revolving loan fund. If a revolving stock fund is selected, the shares compulsorily issued will anyway rank after the ordinary debts of the corporation. If, however, a co-operative with share capital adopts a revolving loan fund, it would appear that section 136 does not apply and that the status and priority of the compulsory loan will depend on its terms. This is an unjustifiable distinction between co-operatives with and without share capital since it is both equitable and desirable that all retained patronage returns should rank after the ordinary debts of the corporation. The Committee recommends that section 136(1) be so amended.

16. **The Committee therefore recommends** that:

(a) the restrictions contained in section 135(2)(a) and section 135(2)(b) of the Act limiting the right of a co-operative to purchase shares for redemption be eliminated;

(b) section 135(2)(c) of the Act be amended by deleting the words "or so as to reduce the number of shareholders to fewer than ten";

(c) the legislation specifically provide that a co-operative may purchase its shares out of capital, subject only to the insolvency test of section 135(2)(c);

(d) shares purchased by a co-operative may either be cancelled by the board of directors at the time of purchase or held for resale;

(e) section 136(1) of the Act be made applicable to co-operatives with share capital.

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1. Apart from a revolving fund, internal sources of finance include shares, fees, member loans, reserves. External sources of finance include banks, credit unions, O.C.C.S. and loans under The Co-operative Loans Act. For an analysis of co-operative financing see O'Meara, *Survey of Co-operatives in Ontario 1966-1967*, Ontario Department of Agriculture and Food (1968).

2. The term "revolving capital fund," as generally used in the co-operative movement is perhaps misleading since it would embrace but not distinguish a revolving stock fund in a co-operative organized with share capital and a revolving loan fund in a co-operative organized without share capital. For reasons of clarity the terms "revolving loan fund" and "revolving stock fund" are used in this Report in preference to the term revolving capital fund.

3. The revolving fund schemes have certain collateral advantages. In practice, co-operatives tend to use retained patronage returns to supplement or even to replace undistributed reserves from surplus largely for tax reasons. Patronage returns are normally deductible for income tax purposes and are regarded as "distributed" even though retained in fact pursuant to a revolving fund scheme. Earnings allocated to a reserve fund on the other hand, are subject to taxation, as undistributed earnings. The accumulated revolving fund can be used for the same purpose as a reserve fund, and a revolving stock plan involves no additional fixed obligations.

4. See, M. T. Woods, When is a Share not a Share, *Canadian Co-operative Digest* (1958).

5. The principle that the member may recoup his investment through withdrawal and the statutory power of a co-operative with share capital to expel members are examined in Chapter 11, *supra*.
6. *Trevor v. Whitworth* (1887), 12 App. Cas. 409.
7. E.g. British Columbia Act, section 12(1); Saskatchewan Act, section 73; New Brunswick Act, section 57(1).
8. Canada Co-operative Associations Act, S.C.1970, c.17, s.17.

CHAPTER 17

Auditors

1. Section 80 of the Act provides that the shareholders and members of a co-operative shall at each annual meeting appoint one or more auditors to hold office until the next annual meeting. This section also vests in the shareholders or members the right to remove any auditor before the expiration of his term of office. Section 82 of the Act sets out the duties of the auditor, gives the auditor a right of access to records, documents, books, accounts and vouchers and provides for the right of the auditor to attend meetings of shareholders and to receive all notices and other communications relating to any such meeting that a shareholder is entitled to receive. Section 168 of The Business Corporations Act, in the provisions relating to the powers of shareholders to remove an auditor, provides a right to the auditor, not given by the Act, to notice in advance of the proposal to remove him and to make representations in writing concerning his proposed removal as an auditor which are to be mailed to shareholders. Section 171 of The Business Corporations Act dealing with the rights and duties of auditors imposes certain additional obligations on the auditor[1] and affords the auditor broader rights of access to required records[2]. The Committee is of the view that the provisions of The Business Corporations Act for the removal of an auditor should be made applicable to the auditor of a co-operative and that the enlarged rights and duties of the auditor conferred and imposed by section 171 of The Business Corporations Act should also apply to the auditor of a co-operative.

2. Section 81(1) of the Act provides that no person shall be appointed as auditor of a company who is a director, officer or employee of that company or an affiliated company or who is a partner, employer or employee of any such director, officer or employee. Subsection (2) of section 81, which is an exception to the general limitation in subsection (1), is not applicable to co-operatives. In order to assure the independence of the auditor, section 170 of The Business Corporations Act has imposed additional limitations on persons who may be appointed as auditor of a business corporation. Subsections (1) and (2) of section 170 of The Business Corporations Act provide as follows:

> "(1) No person shall be appointed or act as auditor of a corporation who is a director, officer or employee of the corporation or of an affiliate of the corporation or who is a partner, employer or employee of any such director, officer or employee or who is a related person to any director or officer of the corporation or of an affiliate of the corporation.
>
> (2) No person shall be appointed or act as auditor of a corporation if he or any partner or employer of or related person to him beneficially

owns, directly or indirectly, any securities of the corporation or of a subsidiary thereof or, if the corporation is a subsidiary, any securities of its holding corporation.".

Submissions were made to the Committee that the auditor of a co-operative should not be precluded from being a member or shareholder thereof and thus entitled to avail himself of the facilities and services of the co-operative. As this Report has noted in connection with other matters, there are basic differences between a co-operative and a business corporation, particularly with respect to the nature of the securities of each. There is no real market for the shares of a co-operative and the shares do not fluctuate greatly in value. The holding by the auditor under these circumstances of shares in or membership of a co-operative of which he is auditor would not appear to the Committee to compromise the independence of the auditor. The auditor of a co-operative should not of course be a director, officer or employee of the co-operative and the provisions of section 170(1) of The Business Corporations Act should be made applicable to the auditor of a co-operative. Section 170(2) of The Business Corporations Act should not be made applicable to the auditor of a co-operative but if the auditor is a shareholder or member of the co-operative he should be required to disclose this in his report to the shareholders or members. However, the Committee does recommend, as a means of promoting the independence of the auditor, that not only should the prohibition in section 170(1) apply to a person who is a director, officer or employee but also to a person who has been a director, officer or employee during the preceding two years. This will avoid the possibility of an auditor reviewing transactions and decisions in which he may have participated as a director, officer or employee.

3. To further assure the independence of the auditor, section 182 of The Business Corporations Act requires the directors of a corporation that is offering its securities to the public to elect annually from among their number a committee to be known as the audit committee. This committee is to consist of not fewer than 3 directors of whom a majority must not be officers or employees of the corporation or an affiliate of the corporation. The Committee has considered whether it would be desirable to extend these provisions requiring the election of an audit committee to co-operatives. The evidence before the Committee indicated that there was no problem of communication between the auditor of a co-operative and its board of directors and that in the case of co-operatives there was no need for an audit committee. The Committee is of the view that an Act relating to co-operatives should not make the election of an audit committee mandatory but should be left on a permissive basis so that, if the board of directors of a co-operative wished to appoint an audit committee, it could do so but without requirement. If an audit committee is elected, the other provisions of The Business Corporations Act relating

to the audit committee and the relationship of the auditor to it should be made applicable in the case of co-operatives. If an audit committee is not elected, the Committee feels that certain additional rights should be given to the auditor of a co-operative. The auditor should be entitled to receive notice of and to attend the meeting of directors at which the financial statements of a co-operative are to be considered and approved. In addition, the auditor should have the right to request the co-operative to convene a meeting of directors to consider any matters the auditor may wish to bring to their attention. This recommendation is in addition to and is not intended to derogate from the present right of the auditor to receive notice of and to attend meetings of members of the co-operative.

4. Section 167 of The Business Corporations Act provides that, where all the shareholders of certain corporations consent in writing, the corporation need not appoint an auditor. Such a corporation must not be offering its securities to the public, must have five or fewer shareholders and must have assets not exceeding $500,000 and sales and gross operating revenues not exceeding $1,000,000 as shown on its financial statements for the preceding year. The Committee considered whether some similar provision could or should be made applicable to co-operatives. While many co-operatives could very well qualify under the asset and sales and gross operating revenue test referred to in Section 167, there are probably few, if any, co-operatives which would have five or fewer members. The provisions of The Business Corporations Act would appear to apply basically to "incorporated partnerships" where the shareholders are probably the operators of the business and in any event familiar with its financial affairs. Such would not be the case with most co-operatives and it is essential in the view of the Committee that the members of a co-operative be afforded the benefit of audit. The Committee does not recommend that there be any exemption in the case of co-operatives from the requirement to appoint an auditor.

5. **The Committee therefore recommends** that:

(a) The legislation affecting co-operatives contain provisions as to the appointment, removal, rights and duties of the auditor of a co-operative similar to the provisions of sections 168 and 171 of The Business Corporations Act;

(b) The legislation should contain provisions similar to section 169 of The Business Corporations Act if it is proposed to appoint an auditor other than the incumbent auditor at the annual meeting;

(c) the legislation contain provisions similar to subsections (1), (5) and (6) of section 170 of The Business Corporations Act and further provide that the prohibition contained in section 170(1) of The Business Corporations Act be extended to a person who

has been a director, officer or employee during the preceding two years;

(d) the auditor of a co-operative not be prohibited from being a member or shareholder of the co-operative;

(e) if the auditor of a co-operative is a member or shareholder, he shall disclose this fact in his report to the members or shareholders;

(f) the legislation contain provisions which would permit, but not require, the directors of a co-operative to elect an audit committee;

(g) if an audit committee has not been elected by a co-operative, the auditor of the co-operative should be entitled to receive notice of and to attend the meeting of directors at which the financial statements are to be approved and upon request of the auditor the co-operative shall convene a meeting of directors to consider any matters the auditor wishes to bring to their attention;

(h) all co-operatives be required to appoint an auditor.

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1. See The Business Corporations Act, 1970, S.O. 1970, c.25, s.171(4), (5) and (7).
2. *Ibid.*, s.171(10) and (11).

CHAPTER 18

Financial Statements

1. The financial statements which the directors of a co-operative with share capital must lay before the annual meeting of shareholders are the same as those required of a business corporation and the disclosure is substantially similar. However, there are certain anomalous differences between the financial disclosure required in the financial statements of co-operatives without share capital and the disclosure required by co-operatives with share capital. By reason of section 116(2) of the Act, a co-operative without share capital is not required to disclose sales or gross operating revenue nor to present comparative financial statements or a statement of source and application of funds. Nor do the provisions of section 89 of the Act in respect of subsidiaries apply to co-operatives without share capital. The disclosure of sales or gross operating income, the presentation of comparative financial statements, a statement of source and application of funds and the information required under section 89 with respect to subsidiaries, if not consolidated, would appear to the Committee to be as important to members of a co-operative without share capital as to the shareholders of a co-operative with share capital. The Committee is not aware of any valid reason for the existence of the differences in the financial disclosure between the two types of co-operatives and recommends that the financial disclosure required from all co-operatives be the same.

2. While the Committee is of the view that the financial reporting requirements for co-operatives, both with share capital and without share capital, should in general be the same as those applicable to the business corporation, there are some areas of financial disclosure which are peculiar to co-operatives in respect of which the Act should make specific provision for disclosure. The statement of general reserve or surplus should show as a separate item (in the same manner as dividends declared) the amount of patronage returns allocated in the year. If a co-operative allocates patronage on the basis of product or groups of products, there should be a requirement for a statement of patronage returns to members broken down to show the amount of patronage allocated to each product or group of products. Member loans and patronage loans should therefore be shown as separate items on the balance sheet.

3. It is important that not only the Director of Co-operatives but also the members or shareholders of a co-operative be informed as to the amount of non-member business transacted by a co-operative in any year. While this might be accomplished indirectly by a statement of the volume and percentage of member and non-member business in the Annual Return, the Committee is of the view that it is desirable that this information form part

of the financial disclosure required of a co-operative, presumably by way of a note to the balance sheet. To eliminate unnecessary expense where the percentage of non-member business is insignificant, as would be the case in a direct charge co-operative, the Committee recommends that the actual percentage of non-member business be disclosed only where this exceeds 20%. Otherwise, it should suffice if a statement is made to the effect that the percentage of non-member business in the relevant period was less than 20%.

4. Representations were made to the Committee that the requirement presently imposed upon a co-operative to file a copy of its financial statements with the Minister be eliminated. It was submitted to the Committee that, since business corporations are not required to file a copy of financial statements, no similar requirement should be imposed on co-operatives. This submission has some justification but in the opinion of the Committee there are reasons why the present requirement should be continued. One of the duties of the Director of Co-operatives as contemplated by the Committee would be to ensure that a co-operative continues to act in accordance with co-operative principles and does not in practice become a business corporation under the guise of a co-operative. The expanded disclosure recommended by the Committee for financial statements of co-operatives can be a valuable source of information to the Director in the discharge of this duty and for this reason the Committee considers that a co-operative should continue to file its financial statements with the Minister.

5. Section 93a of the Act requires a public company to send to its shareholders a copy of a comparative interim financial statement for the six month period following the end of its last completed financial year and for the comparable six month period in the immediately preceding financial year. Co-operatives are specifically exempted from the application of section 93a. The Committee has considered whether the requirement presently imposed on a business corporation to send its shareholders an interim financial statement should be extended to co-operatives. There are of course significant differences between a business corporation and a co-operative. A member or shareholder of a co-operative becomes a member or shareholder not for the primary purpose of making an investment but of availing himself of the facilities and services of the co-operative. Shares of a co-operative may be redeemed under certain circumstances by the co-operative at an amount not exceeding their par value and membership in a co-operative or shares of a co-operative may be transferred only with the approval of the board of directors. The shares of a co-operative have no market in the ordinary sense of that term and there is little possibility of the shares increasing in value. If, as the Committee believes, the provision requiring the furnishing of interim financial statements is designed for the purpose of investor disclosure and to assure possible

investors of reasonably up to date financial information, there would appear to be little need for making the same provisions applicable to co-operatives. The Committee is aware of the need for constant and timely disclosure but considers that to impose a requirement on a co-operative to make available the limited information required under section 93a would impose a burden not commensurate with the advantages. No submissions were made to the Committee that the present exemption applicable to co-operatives should be eliminated and the Committee recommends that the present exemption be continued.

6. Submissions were made to the Committee that for the purpose of disclosure of remuneration of directors and senior officers in the financial statements of a co-operative only those senior officers as defined in section 71(1)(f)(i) be included. Section 71(1)(f) defines "senior officer" to mean:

> "(i) the chairman or any vice-chairman of the board of directors, the president, any vice-president, the secretary, the treasurer or the general manager of a company or any other individual who performs functions for the company similar to those normally performed by an individual occupying any such office, and
>
> (ii) each of the five highest paid employees of a company, including any individual referred to in subclause i;".

In the case of many co-operatives, officers are involved only on a part-time basis and the disclosure presently required would result in ordinary employees of the co-operative being included as senior officers. No useful purpose seems to be served by the inclusion of such employees as senior officers and the Committee has concluded that it should give effect to this submission.

7. **The Committee therefore recommends** that:

(a) the financial disclosure requirements applicable to co-operatives with share capital and to co-operatives without share capital should be identical;

(b) subject to the provisions of clause (c), the financial reporting requirements for co-operatives should be to the fullest extent possible the same as those applicable to the business corporation;

(c) in addition to the financial reporting requirements referred to in (b),

(i) the statement of general reserve or surplus of a co-operative should show as a separate item the amount of patronage returns allocated in the year;

(ii) a co-operative should furnish a separate statement of patronage returns to members where patronage is allocated according to product or groups of products, broken down to show the amount of patronage allocated to each product or groups of products;

(iii) member loans and patronage loans should be shown as separate items on the balance sheet;

(d) a co-operative should be required to disclose either in its financial statements or by way of a note thereto the actual percentage of non-member business transacted in the year where this exceeds 20% or, where the percentage of non member business is less than 20%, by a statement to this effect;

(e) co-operatives not be required to furnish members or shareholders with an interim financial statement;

(f) for the purpose of disclosure of remuneration of directors and senior officers in the financial statements of a co-operative, "senior officers" include only those persons defined in section 71(1)(f)(i) of the Act;

(g) the obligation of a co-operative to file a copy of its financial statements in the office of the Minister be continued.

CHAPTER 19

Position of Co-operatives under the Securities Act

1. Section 19(2)7 of The Securities Act provides that registration is not required to trade in securities issued by corporations operated on a co-operative basis as defined in Part V of the Act. By reason of section 58(2) of The Securities Act, the provisions of section 35, which prohibit a primary distribution to the public unless a preliminary prospectus and a prospectus in respect of the offering has been filed with and accepted by the Ontario Securities Commission, do not apply to securities that are referred to in subsection (2) of Section 19. Consequently, all co-operatives, with the exception of United Co-operatives of Ontario [UCO] on which special requirements are imposed under its Act of Incorporation, as amended, are exempt from the registration and prospectus requirements of The Securities Act.

2. The Special Act of Incorporation of UCO provides that it shall be deemed to be a co-operative company operated on a co-operative basis as defined by Part XII of The Companies Act (now Part V of the Act)[1] and it would thus appear that UCO is entitled to the benefits of the exemptions in The Securities Act. However, when the Special Act of Incorporation of UCO was amended in 1965 to increase its capital by the creation of Class "A" non-voting preference shares and Class "B" non-voting preference shares, the exemption contained in The Securites Act was specifically stated not to apply to its Class "A" or Class "B" preference shares.[2] As a result, UCO is in the position where it enjoys the benefits of the exemptions in relation to its common shares and any debentures or other debt securities it may issue but does not enjoy the benefit of the exemptions in respect of its Class "A" and Class "B" preference shares.

3. The Committee has considered whether the present exemption of co-operatives from the provisions of The Securities Act should be continued. A submission was made to the Committee that there was a need for some degree of supervision and control over the issue of co-operative securities midway between the present situation where there is no supervision (except in the case of UCO) and supervision by the Ontario Securities Commission and it was suggested to the Committee that a co-operatives securities board be established for the purpose of controlling the issue and distribution of securities issued by co-operatives.[3] The Committee is conscious of the general need for adequate disclosure of material facts in relation to the issue and sale of securities but recognizes that there are fundamental differences in the securities issued by co-operatives from securities issued by a business corporation. Shares issued by a co-operative are not listed on a stock exchange, rarely fluctuate in value and may only be transferred with the approval of the board of directors. They are not purchased with a view to capital appreciation or to obtaining a high return since the Act

limits the rate of dividend which may be paid and in any event most of the earnings of a co-operative after provision for necessary reserves are distributed by way of patronage rebates. Persons become members of a co-operative to avail themselves of its services and not primarily for the purpose of investment.

4. For these reasons the Committee has concluded that the present requirements of The Securities Act should not be made applicable to co-operatives and the present exemption should be continued. The Committee considers, however, that those who are asked or seek to become members of a co-operative should be afforded some information with respect to the affairs of the co-operative and favours some supervision and control over the issue of co-operative securities. The Committee does not favour the establishment of a separate co-operative securities board since the number of co-operatives from time to time issuing securities would not appear to be sufficient to warrant the establishment of such a board. In the view of the Committee, the function of supervision and control over the issue of co-operative securities should be vested in the Director of Co-operatives. The Committee would expect the Director to maintain a close liaison with the Ontario Securities Commission in the exercise of his function respecting co-operative securities.

5. The Committee has not given detailed consideration to the content of the prospectus of a co-operative to be filed and cleared with the Director. It need not and should not, in the view of the Committee, be as elaborate as a prospectus required under The Securities Act but should, as a minimum, contain the names of the officers and directors of the co-operative, a general description of the business carried on by the co-operative, its most recently audited financial statement and a statement of earnings and patronage returns over the past five years.

6. As the Committee has noted in Chapter 16, it is the policy of some co-operatives to require members to apply the whole or a portion of their patronage returns in any year to the purchase of shares of the co-operative. This is somewhat similar to the declaration of a stock dividend by a business corporation which enjoys an exemption under section 19(1)8 of The Securities Act. In the view of the Committee, no prospectus need be filed by a co-operative in connection with the enforced purchase of shares through the application of patronage returns.

7. The present position of UCO which is subject to the provisions of The Securities Act in respect of certain but not all of the securities it issues is a matter of some concern. It seemed to the Committee that all securities issued by UCO should either be exempt from The Securities Act to the same extent as the securities issued by other co-operatives, or, if there is reason to subject some types of securities to a greater degree of regulation, then the provisions of The Securities Act should be made applicable to UCO in respect of all its securities. The Committee considers that on

balance and having regard to the nature of co-operative shares there is no reason why UCO should be treated differently from other co-operatives and the Committee recommends that UCO be exempted from the provisions of The Securities Act in respect of all its securities but subject to the recommendations of the Committee with respect to co-operative securities generally.

8. The present exemption in The Securities Act is a revocable exemption and under the provisions of section 19(5) of The Securities Act the Ontario Securities Commission may, where in its opinion such action is in the public interest, order that section 19(2) shall not with respect to such of the securities referred to in that subsection as are provided in the order apply to the person or company named in the order. The exemption contained in The Securities Act should, with respect to co-operative securities, remain on a revocable basis so that if it appears either to the Director of Co-operatives or to the Commission in respect of the securities issued by any particular co-operative that the provisions of The Securities Act need be complied with either from the point of view of disclosure or the method of selling such securities, the Commission could, on its own or at the request of the Director, take necessary action.

9. **The Committee therefore recommends** that:

(a) the exemption contained in The Securities Act with respect to securities issued by co-operatives be retained on the present revocable basis;

(b) the legislation respecting co-operatives contain provision requiring a co-operative in connection with the issue of its securities to file a prospectus with the Director of Co-operatives and to obtain his receipt therefor prior to any sale taking place;

(c) the legislation or regulations passed thereunder make detailed provision for the content of the prospectus required to be filed by a co-operative;

(d) UCO be accorded the benefit of the exemptions contained in The Securities Act with respect to all of its securities but otherwise be made subject to the provisions of the legislation with respect to the issue and sale of securities;

(e) the legislation exempt from the prospectus requirements any issue of shares by a co-operative to its shareholders through the application of patronage returns on an enforced basis.

1. An Act to Incorporate United Co-operative of Ontario, S.O. 1948, c. 130.
2. An Act Respecting United Co-operatives of Ontario, S.O. 1965, c. 173, s. 3(4).
3. In Saskatchewan, a Co-operative Securities Board exists to regulate the public distribution by a co-operative of "bonds, debentures, debenture stock and any securities having a definite date of maturity and bearing interest." See Saskatchewan Act, s. 133.
4. Shares in a co-operative rarely fluctuate because the co-operative continually issues new shares at par value and will usually purchase for cancellation (subject to the restrictions contained in the Act) at par value any shares offered to it by its shareholders.

CHAPTER 20

The Right of a Co-operative to Purchase Shares of a Non-Co-operative Corporation

1. Under section 22(1)(e) of the Act, a company possesses, as incidental and ancillary to the objects set out in the letters patent, the power, "to take or otherwise acquire and hold shares in any other company having objects altogether or in part similar to those of the company or carrying on any business capable of being conducted so as to benefit the company" unless such power is withheld or limited by the letters patent or supplementary letters patent. Section 116(2) provides that all the incidental and ancillary powers contained in section 22 apply, mutatis mutandis, to a corporation incorporated under Part III of the Act to which Part V applies, *i.e.* co-operatives without share capital. Section 124(2) provides that, except where inconsistent with the provisions of Part V, the other provisions of the Act apply to a corporation subject to Part V. Although there is no specific provision in Part V which would make inapplicable to a co-operative with share capital the incidental and ancillary power conferred by section 22(1)(e) the question arises whether the power contained in section 22(1)(e) is inconsistent with the provisions of Part V taken as a whole.

2. In the Report of the enquiry into the affairs of Farmers' Allied Meat Enterprises Co-operatives Limited (FAME), Mr. Justice Grant, the Commissioner, considered and commented upon the right of a co-operative to acquire or purchase shares of another corporation which was not a co-operative. After reviewing the provisions of Part V requiring a co-operative, after setting aside reserves and providing for payment of a limited dividend on shares, to allocate, credit or pay the surplus arising from the business of the co-operative in each fiscal year by way of patronage returns in the manner provided in the Act, the Commissioner stated:

> "Such provisions are so different from the authority of a company not organized under such part that it might well be said that such power to acquire all the shares of a non co-operative company and to control the same thereby is inconsistent with the above provisions. Although FAME would control the Fearman Company, the latter would have no right to issue or deal with patronage dividends as above. Fearman would not be subject to Part V of such Act. As far as I can ascertain, this question has not been decided in any case before the Courts. For the purpose of this inquiry suffice it to say that some question does arise concerning the right of FAME to purchase all the shares of the Fearman Company and to continue to operate that Company in an entirely non co-operative manner."[1]

3. If the correct view is that the provisions of Part V taken as a whole are inconsistent with the power contained in Section 22(1)(e) then the anomalous position emerges where a co-operative without share capital would appear to have the power by reason of the specific provisions of section 116(2) but a co-operative with share capital would not. The situation is unsatisfactory and should be clarified.

4. The Committee appreciates the dangers which may be involved in permitting co-operatives to acquire control of a business through the ownership of shares of a company which is not a co-operative and cannot be operated on a co-operative basis. On the other hand there can be situations where a co-operative, in order to gain control of assets which may be necessary or desirable in the conduct of its business and beneficial to its members or shareholders, can do so only through the acquisition of shares of a non co-operative company. A sale of the assets of a company is generally not as attractive to its shareholders because of the incidence of taxation to the vendor company arising from possible recapture of capital cost allowances on depreciable property sold and the tax burden upon the shareholders resulting from a distribution of the purchase price to them. Consequently, where assets are purchased from a company the purchase price is usually greater in order to compensate the shareholders for the added tax consequences which normally do not exist when shares are sold. The Committee does not consider it would be justified in completely depriving a co-operative of the power to purchase shares of a business corporation. To do so would force a co-operative to acquire assets and put it at an economic disadvantage with a business corporation under like circumstances.

5. Under a section substantially similar to section 22 of the Ontario Act, the British Columbia Act provides that a co-operative association has the power to subscribe to, become a member of and co-operate with or to acquire, take and hold shares in and debentures or other securities of and to guarantee the contracts of any incorporated company or association having limited liability and having objects in whole or in part similar to or conducive to the attainment of its own objects.[2] The British Columbia Act further provides that this power may only be exercised with the written approval of the Supervisor who shall withhold his approval unless he is satisfied after investigation that the proposed exercise of such power is with the bona fide intention of enabling the association to improve its service to its members.[3] The New Brunswick Act[4] contains a provision enabling a co-operative to purchase shares of a non-co-operative corporation but the power may not be exercised unless the Inspector is satisfied that the best interests of the members of the association will be advanced and has transmitted his approval in writing to the Association.

6. The Committee considered whether it would be desirable to incorporate a similar requirement into the legislation in Ontario which would permit

a co-operative to purchase the shares of a non-co-operative corporation only with the prior approval of the Director. Although desirable in principle, this type of requirement has practical difficulties since in order to determine if the purchase would advance the interests of the members or improve services to members, the Director would almost invariably find himself in the position of having to approve the financial aspects of the transaction. This is a matter of management policy and business judgment which should not be the function of the Director and, in any event, the Director should not be placed in the position afterwards of the possibility of any suggestion that because he approved there was some inference he also approved the financial details. On balance, the Committee is of the opinion that the directors of a co-operative are in the best position to determine the needs of the co-operative and whether the purchase of the shares of a non co-operative corporation is in the best interests of the members.

7. It is the duty of the directors of a co-operative to give careful attention and consideration to any transaction involving the purchase of shares of any corporation, whether or not a co-operative. In order to emphasize the importance of such transactions the legislation should provide that the power to acquire shares of a company may only be exercised if the directors, acting in good faith, determine by express resolution that the purchase is in the best interests of the co-operative and is necessary to enable the co-operative to improve its services to members.

8. **The Committee therefore recommends** that:

(a) the power conferred by section 22(1)(e) of the Act be made specifically applicable to co-operatives in clear terms,

(b) the power be exercised only if the directors of the co-operative, acting in good faith, determine by express resolution that the purchase is in the best interests of the co-operative and is necessary to enable the co-operative to improve its services to members.

1. Report of the Commissioner in respect of the Affairs of Farmers' Allied Meat Enterprises Co-operatives Limited, "FAME Inquiry". (1965) p.22.
2. British Columbia Act, s.9(1)(i).
3. *Ibid.*, s.9(2).
4. New Brunswick Act, s.72(1).

CHAPTER 21

United Co-operatives of Ontario

1. With sales in 1969 of over $100 million, assets exceeding $40 million and over 30,000 members, United Co-operatives of Ontario [UCO] is by far the largest co-operative corporation in Ontario.

2. UCO is a major supplier of fertilizers, seeds, petroleum, petroleum products, agricultural machinery, agricultural chemicals and other farm supplies to agricultural producers. It also markets grain and livestock on a commission basis and processes and markets poultry. Until United Dairy Producers Co-operative Limited [UDPC] was organized as a separate co-operative in 1958, it formed the dairy processing and poultry division of UCO which was then the largest dairy processing co-operative in the province. Because of its continued investment in UDPC, UCO still appoints two directors to its Board. UCO maintains connections with other regional co-operatives in Canada and in the United States from which it purchases farm machinery and other goods and is also one of the major shareholders of Co-operators Insurance Association of Guelph, an insurance company owned and organized by the Ontario Credit Union League Limited, Ontario Federation of Agriculture and UCO, which provides insurance services to much of the co-operative movement. In recent years UCO has expanded its commercial activities into retailing farm supplies via branch outlets and has lately established the first of several planned direct charge grocery branches.

3. UCO provides member co-operatives with a variety of services including a management contract scheme under which UCO supplies qualified personnel to manage, on a contract basis, local affiliated co-operatives. An appraisal committee exists to give technical information and advice concerning capital investment contemplated by member co-operatives. Through Patrons Acceptance Limited and Patrons Capital Funding Limited, two wholly owned finance companies, UCO acts as a source of credit to its members for the purchase of supplies and capital assets. UCO has also been active in the propagation of co-operative philosophy by means of education programs. Through its leadership UCO has made a significant contribution to the development of the co-operative movement in Ontario.

4. Because of inadequacies in the general legislation governing co-operatives in 1948, UCO was incorporated by Special Act[1] under which it is deemed to be a "co-operative company operating on a co-operative basis"[2]. It is therefore subject to the co-operative Part of The Corporations Act except where inconsistent with the provisions of the Special Act. The recommendations of this Committee made with respect to matters in which

UCO is presently regulated by the provisions of Part V will thus extend automatically to UCO. Those recommendations made with regard to areas such as the repurchase of shares, delegate voting and the operation of a revolving capital fund which have hitherto been governed by the provisions of the Special Act of UCO rather than the appropriate general provisions of Part V enacted since 1948 are intended to apply to UCO notwithstanding the provisions of its Special Act.

5. UCO was incorporated to succeed United Farmers Co-operative Company Limited as the major regional wholesale co-operative in the province. Since it was intended that UCO should be organized on a federated basis the Special Act of Incorporation originally restricted membership to incorporated co-operatives.[3] However, by the early 1960's a number of local farm supply co-operatives affiliated to UCO were in a precarious financial position. As the major supplier to many such co-operatives and the largest creditor of some, UCO had an important interest in their survival. It was also widely believed that the failure of a single farm supply co-operative would have had serious repercussions upon the whole of the co-operative movement quite apart from the financial losses to the members of the particular co-operative. Some arrangement was therefore necessary to enable UCO to maintain its extensive manufacturing, wholesaling and warehousing services and for the members of ailing local farm supply co-operatives to protect their equity and preserve farm supply services, which in some areas were available only from the co-operative. The solution adopted involved the acquisition by UCO of the affiliated co-operatives in financial difficulties and the continuation of their operations as branch outlets of UCO.

6. An amendment to the Act of Incorporation was required to enable UCO to acquire such autonomous farm supply co-operatives and to permit the admission to membership in UCO of individual members of the co-operatives thus acquired. In 1965, an amending Act was passed which, inter alia, changed the membership structure to permit individuals in addition to incorporated co-operatives to qualify for membership in UCO.[4]

7. The deletion of the provision in the Special Act of Incorporation restricting membership exclusively to incorporated co-operatives ended the traditional separation between the wholesale and retail tiers of the co-operative movement in Ontario and marked a fundamental change in its character and future trend.

8. Following the absorption of those farm supply co-operatives in pressing financial difficulties several other co-operatives elected to merge with UCO. These were principally co-operatives in need of new facilities in order to maintain a satisfactory service to members but unable to raise sufficient funds because of their uncertain future. The members of such co-operatives

were often reluctant to invest in their own local co-operative but were willing to invest in the central wholesale co-operative and a merger with UCO was regarded by such co-operatives as a realistic means of ensuring the continuation of their services. Certain co-operatives already managed on a contract basis by employees of UCO under the management agreement scheme also found it advantageous to merge with UCO.

9. Of the approximately 135 independent co-operatives affiliated to UCO in 1965, 62 have since merged increasing the membership of UCO to over 30,000 and it is probable that many of the remaining autonomous co-operatives will be absorbed by UCO in the foreseeable future. UCO can no longer be considered to be solely, or indeed principally, a wholesale co-operative.

10. The absorption of local autonomous farm supply co-operatives with traditions of frequent and informal contact between management and membership into a centralized co-operative with a total membership exceeding 30,000 inevitably raises questions concerning the preservation of democratic control. The Special Act of Incorporation provides for a delegate voting system similar to that subsequently enacted as section 137 of Part V and the Committee was advised in a submission from UCO that the following additional measures are taken to promote consultation and co-ordination between the management and board of directors of UCO, its branch outlets and affiliated locals.

> "Incorporated locals are encouraged to have active Boards of Directors meeting monthly and to have informative and well attended annual meetings with open elections. Retail branches of UCO have active annual meetings and elect Co-operative Councils most of which meet eight times a year. From the local elected Boards and Councils come the 349 to 436 eligible delegates which attend a two-day annual meeting of UCO. These elect twelve directors to the Board of UCO which meets two full days every month. One or two series of eleven zone meetings for directors and councillors are held each year across the province. There is an annual Presidents' Conference. UCO reports monthly through the UCO Leader to all local directors and councillors (and managers), featuring review of the Provincial Board meeting by the Provincial President. UCO News goes to 50,000 members six times a year. UCO Urban News goes to 6,000 city members. CO-OP Reporter goes six to eight times a year to 1,700 employees of UCO and UDPC. The pamphlet "Progress Through People" was distributed to 11,000 co-operative members."

11. While the measures taken thus far have no doubt provided individual members of UCO with some opportunities to express their views on the conduct of the affairs of their co-operative they cannot of course replace the traditions of frequent and informal contacts between membership and

management possible in local co-operatives or be equated with the concerted influence of the members of local autonomous co-operatives affiliated to a regional co-operative organized on a federated basis. The "Co-operative Councils", established pursuant to a by-law of UCO, are vested only with such powers as UCO chooses to delegate. As a matter of practice the Co-operative Councils (or local advisory councils as they are referred to in the legislation) have no executive powers.

12. The expansion of UCO into retail branch trading is perhaps the most controversial area of its current development and has aroused some concern over the emergence and consolidation within the co-operative movement of a single co-operative dominant in size and influence.

13. Despite criticism that the entry of UCO into retail branch operations has breached the former separation between the wholesale and retail tiers of the co-operative movement in Ontario resulting in the depersonalization and loss of member participation which is bound to accompany centralization, it would seem to the majority of the Committee that the expansion of UCO's services by the selective acquisition of a number of affiliated locals was the inevitable culmination of the growing indebtedness to and dependence upon the services of UCO by local farm supply co-operatives in Ontario. Other members of the Committee, however, do not share this sense of inevitability. The trend towards centralization which, the Committee is advised, exists also in other provinces, illustrates the present compromise in Ontario between co-operative ideals and the exigencies of commercial efficiency alluded to in Chapter 1 of this Report.

14. The Committee is concerned that the present trend may result in the depersonalization of UCO and recommends that UCO initiate an internal in-depth examination of further means in order to ensure that the substance of the principles of democracy and member participation will be strengthened in an increasingly complex multi-purpose co-operative.

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1. An Act to Incorporate United Co-operatives of Ontario, S.O. 1948, c.130.
2. *Ibid.*, s.17.
3. S.5(1) originally provided:
   "s.5(1) The common shares of the Company shall be sold to, owned or held only by co-operative corporations incorporated under the Companies Act or other corporations however incorporated (whether under the laws of the Province of Ontario or under any other laws) which, in the opinion of the directors of the Company, are operating as co-operatives."
4. S.5(1) was effectively repealed in 1965 by An Act Respecting United Co-operatives of Ontario, S.O. 1965, c.173, s.4.

CHAPTER 22

Direct Charge Co-operatives

1. In the original co-operative store established by the Rochdale Pioneers goods were sold at their ordinary retail price.[1] Some consideration was apparently given to selling goods at cost price which, since the purpose of the co-operative store at Toad Lane was to reduce the costs of necessaries by eliminating the exorbitant profits of shopkeepers, might seem logical. But this idea was apparently rejected for several reasons[2] and even today the typical consumer co-operative operates by charging retail prices competitive with those charged by other commercial enterprises, distributing the surplus realized by the co-operative in accordance with the amount of patronage of the member. A consumer co-operative normally deals with members and non-members alike, but either restricts patronage returns to members only or pays a lower rate of patronage to non-members. While there are isolated examples of consumer co-operatives in Ontario, the consumer co-operative movement has never really gained a foothold in this province.

2. There has recently been pioneered in Ontario[3] a consumer co-operative which differs from the ordinary co-operative in that it deals only with members and sells its goods at cost price. A limit on the number of members of such a co-operative is, in effect, imposed in advance based on the optimum operating size of the co-operative. Operating expenses are calculated on a quarterly basis and are charged directly to members in the form of a fixed weekly fee payable regardless of the amount of a member's purchases or whether he has patronized the co-operative at all. The inventory and capital expenses of the co-operative are financed from membership capital which in Ontario is hitherto in the form of shares payable in instalments.

3. The sale of goods at cost is perhaps both the basic strength and weakness of the direct charge co-operative. The policy of "instant patronage" assures a return of the maximum possible savings to members without the delay which accompanies the distribution of accumulated patronage returns. Catering only to the household needs of a committed group of patron members, it can operate from unpretentious premises and eliminate advertising costs and related expenditures of ordinary consumer co-operatives which operate in open competition with supermarkets.[4] This affords an opportunity for member participation, often in the form of voluntary help in the store, which has long disappeared in most conventional co-operatives. On the other hand, the operation of direct charge co-operatives is required to be more efficient than any ordinary consumer co-operative since there is no reserve to absorb unforseen losses. This limits the range of goods it can offer its members and accentuates the possible dangers of

relying upon voluntary amateur management. Any failure to estimate with a high degree of accuracy anticipated operating expenses, a proper allowance for shrinkage and inventory needs can quickly produce losses. A direct charge co-operative is therefore dependent for its viability upon the continued allegiance of its members through payment of a weekly fee and continuing contributions to its capital.

4. The operating success of direct charge co-operatives in Ontario is, thus far encouraging. Of the 12 direct charge co-operatives established to date, only one has failed although one or two others have encountered temporary financial difficulties. The guidance of the New Co-operative Co-ordinating Committee, an association organized to foster direct charge co-operatives, and the advice and management assistance available from UCO to which some direct charge co-operatives are affiliated are factors which have helped to promote the sound management of direct charge co-operatives.

5. The Committee was advised that the present legislation poses certain difficulties for direct charge co-operatives and a submission was made that there should be special provisions governing direct charge co-operatives in the legislation. The Committee has given this submission close consideration but, apart from those matters referred to in this Chapter, is of the opinion that no other specific provisions need be made in the legislation to accommodate the operation of direct charge co-operatives. Apart from the fact they operate at cost, producing no surplus for later distribution by way of patronage returns, there is no essential difference between the direct charge co-operative and other co-operative corporations except perhaps from a philosophical point of view which would be difficult to translate into legislation.

6. Almost all the direct charge co-operatives now operating have been incorporated with share capital. This form of organization poses difficulties with respect to the purchase by the direct charge co-operative of the share interest of a member who wishes to withdraw. The absence of any operating surplus and therefore of any reserve, presently precludes the possibility of the repurchase by a direct charge co-operative of a member's shares under the authority of section 135. The earlier recommendation of the Committee that co-operatives be empowered to repurchase shares from capital or surplus[5] would not assist a direct charge co-operative because of the proposed limitation that no purchases be permitted if the co-operative is insolvent or would thereby be rendered insolvent. As defined in The Business Corporations Act "a corporation is insolvent if its liabilities exceed the realizable value of its assets or if the corporation is unable to pay its debts as they become due".[6] This definition of insolvency would, it is anticipated, be made applicable to co-operatives for the purpose of the repurchase of shares. Direct charge co-operatives however operate so close

to insolvency as defined above that difficulties might arise in determining at any time whether the direct charge co-operative was "solvent" as so defined for the purpose of repurchasing shares. On balance, however, the Committee considers that the insolvency test should nevertheless apply to direct charge co-operatives as a condition for the repurchase of their shares.

7. Under section 133(1) of the Act the surplus arising from the business of a co-operative in each fiscal year, after setting aside of a reserve and payment of a limited dividend, must be allocated, credited or paid to members or shareholders in the manner set out in the section. While it is unlikely that a direct charge co-operative would ever have any large amount of surplus, it is possible, through over-budgeting that a surplus could result at year end. Any such surplus would probably be used in subsequent periods to reduce the weekly fee and in any event the records which would have to be kept by a direct charge co-operative to allocate, credit or pay such surplus in accordance with section 133 would not seem to justify the effort. It is therefore recommended that direct charge co-operatives be exempted from the operation of this section, particularly since the theory of a direct charge co-operative is "instant patronage" through the supply of goods at cost.

8. It was also submitted to the Committee that the legislation should provide that upon the winding up or liquidation of a direct charge co-operative no part of its assets should accrue to the benefit of the members. Section 136(2) of the Act provides:

> "136(2) A corporation may enact by-laws providing that, upon the dissolution of the corporation and after the payment of all debts and liabilities, including any declared and unpaid dividends and the amount paid up on outstanding shares, if any, the remaining property of the corporation or part thereof may be distributed or disposed of,
>
> (*a*) equally among the members or shareholders irrespective of the number of shares held by a shareholder;
>
> (*b*) among the members or shareholders at the time of dissolution on the basis of patronage returns accrued to such members or shareholders during the five fiscal years immediately preceding the dissolution or after the date of incorporation; or
>
> (*c*) to charitable organizations or to organizations whose objects are beneficial to the community."

The Committee does not consider that any special provision need be made for direct charge co-operatives. It should be open to the members of such a co-operative to determine this matter for themselves by an appropriate by-law under section 136(2).

1. Although included in the list of original principles compiled by Holyoake's *History of the Rochdale Pioneers* (1907) its status has frequently been put in question. As noted in E. P. Roy, *Cooperatives: Today and Tomorrow* (2nd ed. 1969), p. 209:

"This is really not a co-operative principle but a business policy which can be changed from time to time as economic conditions demand. The significant point is whether co-operatives wish to pass on the dividend day-by-day or in a lump sum at year's end".

2. The initial practice of selling goods at their retail price has been attributed by some to the probable desire of a fledgling co-operative not to antagonize shopkeepers by undercutting. It seems more likely, however, that the idea of selling goods at cost was rejected by the Rochdale Pioneers because they viewed the store at Toad Lane as part of what was intended to grow into a self-supporting community organized on co-operative lines. It was therefore necessary to produce a surplus so that some of the savings could be reserved for future expansion or allocated to educational programmes. Prudent business practices also dictated the margin for reserves against unforeseen losses resulting from the inexperience of the management. In addition it was also feared that the abundant supply of labour might encourage unscrupulous employers to lower wages still further if it became known that food and household necessaries were available at reduced prices. Another factor was that the accrual of patronage returns in a co-operative and distributed on a periodic basis provided members with a means of accumulating small sums. See G. D. H. Cole, *A Century of Co-operation* (1944).
3. For a brief history of the direct charge co-operative, see R. S. Staples, The Direct Charge Consumer Co-operative, *Canadian Co-operative Digest,* (1970), vol. 13, no. 1, p. 7.
4. These are some of the advantages which make the concept of the direct charge co-operative a potentially useful tool in aiding the economically underprivileged. See J. M. Rose, Direct Charge Co-operatives, Legal Aspects of a New Strategy In the War on Poverty, 38 *Geo. Washington Law Rev.* p.956.
5. Chapter 16, *supra.*
6. The Business Corporations Act, 1970, S.O. 1970, c.25, s.1(7).

CHAPTER 23

Marketing Boards and Marketing Co-operatives

1. Marketing boards and marketing co-operatives share certain basic objectives. Both represent attempts to improve the bargaining position of agricultural producers by means of combination and to achieve for the producers higher and more stable prices by the orderly marketing of their products. But although the predominant aims of marketing boards and marketing co-operatives are similar, their methods are divergent and perhaps irreconcilable.

2. A marketing co-operative consists of a group of producers who have voluntarily chosen to organize a co-operative in order to provide themselves with an alternative to existing commercial marketing enterprises. Their success depends upon their ability to operate at least as efficiently as their commercial counterparts and the strength of the co-operative depends upon their ability to persuade other producers through demonstrable savings to prefer the co-operative to its competitors.

3. Marketing boards, by way of contrast, are compulsory bodies imposed by law upon all producers in an industry and therefore operate in monopoly conditions. They have powers that may require all produce to be sold to the board at a stipulated price and may include the marketing of the product, but more usually are limited to controlling the prices at which the regulated product may be sold without undertaking responsibility for marketing arrangements.[1]

4. Marketing boards usually follow co-operatives in point of time and are generally imposed because marketing co-operatives are absent or have not been able to provide an effective alternative to commercial marketing enterprises where these do not meet the expectations of the producer. The establishment of a marketing board is usually the result of a choice between ineffective voluntary co-operation and effective co-operation with some compulsion.

5. There are in Ontario some 22 marketing boards, twenty of which are governed by The Farm Products Marketing Act[2] and the remaining two by the Milk Act.[3] The majority of marketing boards act only as price regulating bodies but some, including these established under The Milk Act, perform marketing functions in addition to regulating the price of controlled products. The Committee did not consider in detail the virtues and structure of marketing boards vis-a-vis co-operatives, but only their effect upon marketing co-operatives where a marketing plan is imposed and of major concern to the Committee were the specific problems confronting co-operatively owned milk processing plants and milk transporting facilities since the establishment of a Milk Plan under The Milk Act, 1965.

6. The Milk Act, 1965 was enacted shortly after the Report of the Ontario Milk Industry Inquiry had revealed "an undesirable multiplicity of organizations with overlapping memberships and conflicting objectives". The Report noted that "the major theme for the past 15 years has been the unsuccessful efforts of the producer organizations to come to recognition of mutual interests and of the folly of narrow, partisan behaviour. There is conclusive evidence that sensible compromise and constructive joint action will not be attained on a voluntary basis".[4]

7. Under the Milk Act the main executive body is the Milk Commission composed of "not fewer than three members who shall be appointed by and hold office during the pleasure of the Lieutenant Governor in Council".[5] and is responsible to the Minister of Agriculture and Food. The Milk Commission is in effect vested with all the original powers contained in The Milk Act and is authorized to delegate by Regulation, on a terminable basis, any or all of its powers to a marketing board, including the power to make Regulations. A marketing board is defined in section 1 of the Milk Act as "a board constituted under a plan" and a plan "means a plan that is in force under this Act to provide for the control and regulation of the marketing of milk, cream or cheese or any combination thereof"[6]. A plan may be established either pursuant to Regulations promulgated by the Lieutenant Governor in Council or by the Minister based on a petition of a group of producers favourably reported on by the Milk Commission.

8. In 1965 a Milk Plan was established by Regulation to The Milk Act which created the Ontario Milk Marketing Board, (O.M.M.B.) a body composed of not more than 12 members appointed by the Lieutenant Governor in Council and elected by 12 Regional Committees.[7] In the same year, the Milk Commission, acting by Regulation, delegated to the O.M.M.B. broad powers including the power "to stimulate, increase and improve the marketing of milk by such means as the Marketing Board deems proper".[8]

9. A number of Regulations have been made by the O.M.M.B. concerning various aspects of the production, processing and marketing of milk under the Milk Plan, but the Regulations which were of prime concern to this Committee because, it was submitted, they impinge upon the freedom of producers to patronize the co-operative of which they are members, are those which have established what is termed as the "Rationalization of Regional Flow of Milk" affecting industrial grade milk and "Route Rationalization" affecting grade A milk. The aim of these Regulations is to minimize the distance and time between a producer and a milk processing plant and thereby to encourage the less costly and more efficient processing of raw milk. Pursuant to the policy of Rationalization of the Regional

Flow of Milk, Regulations require producers to sell all industrial grade milk exclusively to the O.M.M.B. and all processors to purchase their supplies from the O.M.M.B. which is then directed by the O.M.M.B., as sole supplier, to the closest suitable processing plant licensed and designated by the O.M.M.B. according to demand and quota.[9] Regulations implementing the policy of Route Rationalization require a particular producer's grade A raw milk to be transported to the designated processor by a milk transporter licensed and appointed by the O.M.M.B.[10]

10. The interposition of the O.M.M.B. between the producer member and his processing co-operative has created serious operating difficulties for the 30 or so co-operatively owned industrial milk processing plants since it effectively prevents a member from dealing directly with his co-operative. The co-operative is unable to grant any patronage rebates on the milk purchased from the O.M.M.B. for apart from the practical difficulty of determining for patronage purposes whether milk purchased from the O.M.M.B. by a co-operative processor represents the produce of a member of that co-operative sold to the O.M.M.B., s.133(1) of Part V requires that

> ". . . the surplus arising from the business of a corporation in each fiscal year shall be allocated, credited or paid to the member or shareholder in proportion to the business done by each member or shareholder *with or through* the corporation . . .".

Since it cannot be maintained that a member producer who is required by law to deal exclusively with the O.M.M.B. transacts business "with or through" his co-operative, the co-operative cannot make patronage rebates to its members. Co-operatives thus affected may continue to pay a dividend on shares subject to the statutory limit of 8% per annum, but any remaining surplus must be added to taxable reserves. There is little incentive for members who cannot deal with their co-operative to continue their membership and it is open to question whether a co-operative which is prevented by law from transacting any business with its members can or should continue to exist as a co-operative corporation.

11. Under the Milk Plan, the expense of transporting milk from the farm to the processing plant designated by the O.M.M.B. is borne by the producer. The minimization of the costs of such transportation is therefore of considerable importance.

12. There are in Ontario some 8,000 grade A milk producers who belong to Group I Pool established as part of the Milk Plan. Of these 8,000 producers, some 400 to 600 or about 5%, are members of the 10 trucking co-operatives serving the area covered by the Group I Pool. The net savings afforded to members of the ten Milk Transportation Co-operatives in the province by way of patronage return have been substantial. Figures submitted to the Committee indicate that in 1969 seven out of the ten

Milk Transportation Co-operatives paid a patronage return of over 20% to its members and in dollar terms the savings range as high as $509.00 per member per annum.

13. As a result of Route Rationalization, certain producers who belong to one of the ten transportation co-operatives are no longer permitted to use transportation provided by their co-operative because they do not come within the route prescribed by the O.M.M.B., while the co-operative is obliged to transport the milk of non-member producers which happen to be situated along its approved route.

14. The financial effects of this Route Rationalization scheme are reported to be considerable. Those member producers prevented from patronizing their transportation co-operative because they are situated outside its prescribed route are required to use commercial transportation licensed and designated by the O.M.M.B. and to pay commercial rates. The Committee has not made a detailed study of the cost effect of Route Rationalization but notes that the Federation of Co-operative Milk Transports is not yet satisfied that the policy of Route Rationalization has produced the intended savings in transportation costs.

15. The O.M.M.B. or the Milk Commission have power to exempt any of those affected from the application of any Regulation,[11] or to appoint such co-operatives as its agents,[12] a move which could restore the direct relationship between a member and his co-operative essential to the operation of the co-operative. It would seem to the Committee that the extent of any discretionary exemption or relief accorded to co-operatives adversely affected by a marketing plan is in substance a matter of governmental policy vested ultimately in the Minister of Agriculture and Food, but the Committee wishes to record its concern over the incidental effects that some Regulations have had on certain co-operatives in the hope that a means can be found to implement the Milk Plan without jeopardizing the future existence of dairy co-operatives.

16. The Committee is advised that at least one co-operative affected by the Milk Plan is currently seeking conversion to an ordinary corporation under section 141 of the Act. The Committee has earlier considered the cumbersome procedure under section 141 which requires the discretionary consent of the Lieutenant Governor in Council and recommends that where a marketing plan deprives a co-operative of its ability to deal with its members, the Minister should be empowered, upon application by the co-operative, to order its conversion to an ordinary corporation forthwith.

1. See generally, *Final Report of the Co-operative Union of Ontario Commission on Relationships between Co-operatives and Marketing Boards* (1961).
2. R. S. O., 1960, c. 137.

3. S. O., 1965, c. 72.
4. *Report of the Ontario Milk Industry Inquiry Committee* (1965), p. A-1.
5. S. O., 1965, c. 72, s. 3(2).
6. *Ibid.*, s. 1.19.
7. The Ontario Milk Marketing Plan, O. Reg. 250/65.
8. O. Reg. 294/65.
9. O. Reg. 146/70.
10. O. Reg. 52/68; 71/68.
11. *Ibid.*, s. 8(1)9.
12. *Ibid.*, ss. 4(2)(h): 4(4): 8(1)43.

CHAPTER 24

Miscellaneous

1. Historically, Ontario co-operatives marketing agricultural products were financed by initial loans or purchase of shares and by borrowings from banks or government. Subsequently, additional capital in the form of patronage loans or retained patronage rebates in the form of shares provided more capital (assuming, of course, an operation which had a surplus to return).

2. As an additional means of raising finance from within the membership, several co-operatives have examined the possibility of assessing patron members on the volume of produce marketed through the co-operative by deducting a percentage from the proceeds due to a member arising from the sale of his produce by the co-operative and either retaining such deducted sums as compulsory loans or applying such sums towards the purchase of shares. Under present legislation it is possible to withhold and retain as loans or apply towards the purchase of shares the whole or any part of patronage rebates owed to a member[1] but there is no provision empowering a co-operative to retain other amounts owed to and held for a member by the co-operative. In the absence of an enabling provision the individual consent of each member would be required to authorize separately each such deduction, a procedure which is impracticable in a large co-operative.

3. It was suggested to the Committee that the Act should empower a co-operative to enact a by-law to permit such deductions to be made and retained as compulsory loans or applied towards the purchase of shares in a manner similar to that permitted for patronage rebates. Such deductions might later be returned to the member on a revolving fund basis.

4. As a means of financing the services of the co-operative, deductions based on the volume of goods marketed accord with the co-operative precept that a member's equitable contribution towards the cost of operating the co-operative should be related to the use made of its services. The Committee is of the view that a co-operative should be empowered by by-law to make percentage deductions according to volume from amounts due to members from the marketing of their produce through the co-operative, and retain such sums as compulsory loans to the co-operative for such term and upon such conditions as the by-law may provide, or to apply such sums towards the purchase of shares which would be subject to repurchase. Shares issued in respect of deductions would presently be subject to a maximum dividend of 8% per annum, and since loans resulting from deductions would in substance be similar to patronage loans, the Committee considers that the rate of interest payable on such loans should also be limited to a maximum of 8% per annum.[2]

5. The Act presently stipulates that shares in a co-operative "shall have a par value of $5.00 or any multiple of $5.00 not exceeding $100.00".[3] It was submitted to the Committee that some inconvenience arises from the $5 minimum par value and that the par value of co-operative shares should be reduced to a minimum of $1. The Committee recommends that the minimum par value of shares in a co-operative be reduced from $5 to $1.

6. It was suggested to the Committee that the provisions presently required to be stated in the share certificate of a co-operative are unduly complex and prolix, resulting in some inconvenience to those co-operatives regularly issuing shares in lieu of cash patronage rebates.[4] The Committee considers that co-operatives should continue to be required to issue share certificates if requested by a member but that some attempt should be made to simplify their form and content. Without stipulating in detail the means by which this might best be accomplished, the Committee recommends that the share certificate of a co-operative contain the information presently required for share certificates of companies subject to The Business Corporations Act[5] plus a statement that the shares represented by the certificate are not transferable without the authorization of the directors. The certificate should also contain a statement to the effect that the shares represented thereby are subject to the provisions of the co-operative legislation.

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1. Section 134(1), see Chapter 16, *supra*.
2. See Chapter 14, *supra*.
3. Section 126(1).
4. In addition to the general provisions of the Act which require that:

> "Every share certificate, . . .
>
> (b) shall state the number and class of shares represented thereby and whether the shares are with par value or without par value and, if partly paid, the amount paid up thereon or that the shares are fully paid, as the case may be; and
>
> (c) if it represents preference shares, shall state thereon in legible characters the preferences, rights, conditions, restrictions, limitations or prohibitions attaching to the class of preference shares to which it belongs;" (Section 45(1))

the share certificate of a co-operative subject to Part V, issued after April 30, 1954, must:

> "(a) bear upon its face the name of the company, the words "incorporated as a co-operative company and subject to Part V of *The Corporations Act* (Ontario)" and a statement of the authorized capital, but, where some but not all of the shares of a class are purchased for redemption or some but not all of the preference shares of a class are converted, redeemed or purchased for cancellation, it is not necessary to change such statement of the authorized capital;
>
> (b) state the information required by clauses *b* and *c* of subsection 1 of section 45;
>
> (c) state that the shares represented by the certificate are not transferable without the authorization of the directors;

(d) set forth the provisions of section 135;

(e) state that the dividend, if any, to which the holder of a share may become entitled shall not exceed 8 per cent per annum of the amount paid up thereon; and

(f) state that the company may be by-law limit the amount to be distributed for each share on the dissolution of the company to the amount paid up on such share together with declared and unpaid dividends." (Section 126 (2))

5. The Business Corporations Act, 1970, S.O. 1970, c. 25, ss. 50, 51.

APPENDIX A

Reformulation of the Rochdale Principles by The International Co-operative Alliance in 1937.

"After careful study of the available facts the Special Committee have come to the conclusion that the following seven points may be considered from the historical point of view as the essential Principles of Rochdale and the characteristics of the autonomous system founded by the Pioneers, for each of which justification can be found in the constitution, rules and practice of the original Society, founded at Rochdale in 1844:

I. Open Membership

II. Democratic Control

III. Dividend on Purchase

IV. Limited Interest on Capital

V. Political and Religious Neutrality

VI. Cash Trading

VII. Promotion of Education

Certain other essential conditions of the constitution and practice of co-operative societies have inevitably emerged during the discussions, which it is absolutely necessary to include in this report as representing the co-operative system, some of them to no less a degree than the seven principles already dealt with which are enshrined in the rules and practice of the Rochdale Society. In this category are:

1. Trading Exclusively with Members
2. Voluntary Co-operation

Two other subjects that have been mentioned, neither of which can be said to be essential to any definition of the Rochdale System, are:

1. Sale at Current or Market Price
2. Disposal of Collective Assets

. . . that portion of the collective assets which is derived directly from genuine co-operative activities results largely from the operations of the past members of the society on which the members remaining at the time of the liquidation have no legitimate claim.

The consumers' co-operative movement of the world is generally, but insufficiently and incompletely, based upon the principles laid down by the Weavers of Rochdale in the statesman-like construction and subsequent practice of the Rochdale Society of Equitable Pioneers in 1844. It was

inevitable that within the spheres of forty national movements, each interpreting standard doctrines according to their mental or racial habitudes, and influenced, to however small an extent, by the legislative and commercial customs of their respective countries, there should develop some variations in the application of even such universally applicable principles as those of Rochdale . . . The committee feel that there is good ground for satisfaction that the character of mutuality and solidarity, of our particular economic system has been so fully maintained. It would appear that these principles contain the essential principle of life, which is the highest test of their genuineness . . .

The committee . . . desire to express their conviction that the seven principles as set out at the beginning of this report still represent the essential basis of the Rochdale system, and that nothing in the modern developments of industry and commerce, or changes in economic method, has diminished their integrity . . .

The committee are of the opinion that there should be some discrimination in the importance to be attached to these seven points in deciding the essential co-operative character of any society or organization. They suggest that the observance of co-operative principles depends on the adoption and practice of the first four of the seven principles:

I. Open Membership

II. Democratic Control (one man, one vote)

III. Distribution of the Surplus to the Members in Proportion to Their Transactions

IV. Limited Interest on Capital

In the opinion of the committee the remaining three principles,

V. Political and Religious Neutrality

VI. Cash Trading

VII. Promotion of Education

while undoubtedly part of the Rochdale System, and successfully operated by the co-operative movement in the different countries, are, however, not a condition for membership of the I.C.A."

The Essential Principles of Co-operative Organizations
as approved by the International Co-operative Alliance in 1966

"The following should continue to be considered as essential to genuine and effective co-operative practice both at the present time and in the future as far as that can be foreseen:

1. Membership of a co-operative society should be voluntary and available without artificial restriction or any social, political or religious discrimination, to all persons who can make use of its services and are willing to accept the responsibilities of membership.

2. Co-operative societies are democratic organizations. Their affairs should be administered by persons elected or appointed in a manner agreed by the members and accountable to them. Members of primary societies should enjoy equal rights of voting (one member, one vote) and participation in decisions affecting their societies. In other than primary societies the administration should be conducted on a democratic basis in a suitable form.

3. Share capital should only receive a strictly limited rate of interest, if any.

4. Surplus or savings, if any, arising out of the operations of a society belong to the members of that society and should be distributed in such manner as would avoid one member gaining at the expense of others.

This may be done by decision of the members as follows:

(a) by provision for development of the business of the co-operative;

(b) by provision of common services; or

(c) by distribution among the members in proportion to their transactions with the society.

5. All co-operative societies should make provision for the education of their members, officers, and employees and of the general public, in the principles and techniques of Co-operation, both economic and democratic.

6. All co-operative organizations, in order to best serve the interests of their members and their communities, should actively co-operate in every practical way with other co-operatives at local, national and international levels."

—Formulated by the ICA Commission on Principles and adopted at the 23rd ICA Congress in Vienna, September 1966.

APPENDIX B

Memorandum of the Registrar of Industrial and Provident Societies, England

The Industrial and Provident Societies Act, 1965 provides that a society may be registered under that Act "only if the Registrar is satisfied that the society is a bona fide co-operative society" (s.1(2)), but the Act does not elaborate upon what determines a "bona fide co-operative society". The only other relevant provision qualifies in a very general way the scope of the "co-operative society" which is defined as excluding a society "which carries on or intends to carry on business with the object of making profits mainly for the payment of interest, dividends or bonuses, on money invested or deposited with or lent to, the society or any other person". (s.1(3)). The Registrar of Industrial and Provident Societies has attempted to provide some extra-statutory guidelines as to what constitutes a bona fide co-operative society in the form of a memorandum which is quoted below:

> "The Act does not define a bona fide Co-operative Society, but the nature of such a Society may be indicated in a general way by the following observations:
>
> (a) An investment Society as defined in Sub-section (9) is expressly excluded, i.e. a Society which is carried on with the object of making profits mainly for the payment of interest on money invested with or through the Society.
>
> (b) The Society must so conduct its business as to show that its main purpose is the mutual benefit of its members, and that the benefit enjoyed by a member depends upon the use which he makes of the facilities provided by the Society and not upon the amount of money which he invests in the Society. In a retail Society or a social club run on co-operative lines (to mention two familiar examples), a person who takes up the minimum shareholding necessary to qualify for membership participates in the benefits of membership in proportion to the amount of his purchases from the Society or the extent to which he uses the amenities of the club, as the case may be. In other words, the profits in the one case are distributed mainly as dividend on purchases and not as dividend on capital, and in the other case are devoted to improving and cheapening the facilities of the club. By contrast a Society which is not co-operative usually aims at making profits with a view to applying them on the basis of the amount of money invested or to the advantage of promoters and the like. In the case of such Societies as Agricultural Co-operative Societies, although the member may be required to

take up shares in proportion to the amount of his land or stock, etc., the Society nevertheless exists primarily to provide benefits for the member in proportion to the use which he makes of the marketing or other facilities furnished by the Society.

(c) There must be no artificial restriction of membership with the object of increasing the value of proprietary rights or interests. On the other hand there may be reasons for restricting membership which would not offend the co-operative principle, e.g. a club's membership may be limited by the size of its premises; a Society may confine its activities to a particular class of persons or to a particular area. By contrast, if the membership were limited in order to give the maximum benefit to a restricted number of persons the Society might not be regarded as truly co-operative.

(d) A rule providing that any persons should have more than one vote might suggest *prima facie* that the Society was not a true Co-operative Society.

(e) The return on share and other capital must not exceed a moderate rate which may vary according to circumstances but should be approximate to the minimum necessary to obtain such capital as is required to carry out the primary objects of the Society."

APPENDIX C

Extracts from The Business Corporations Act, 1970, S.O. 1970, c.25.

Representative actions on behalf of corporation

99.—(1) Subject to subsection (2), a shareholder of a corporation may maintain an action in a representative capacity for himself and all other shareholders of the corporation suing for and on behalf of the corporation to enforce any right, duty or obligation owed to the corporation under this Act or under any other statute or rule of law or equity that could be enforced by the corporation itself, or to obtain damages for any breach of any corporation itself, or to obtain damages for any breach of any such right, duty or obligation.

Leave

(2) An action under subsection (1) shall not be commenced until the shareholder has obtained an order of the court permitting the shareholder to commence the action.

Application for order to commence action

(3) A shareholder may, upon at least seven days notice to the corporation, apply to the court for an order referred to in subsection (2), and, if the court is satisfied that,

(*a*) the shareholder was a shareholder of the corporation at the time of the transaction or other event giving rise to the cause of action;

(*b*) the shareholder has made reasonable efforts to cause the corporation to commence or prosecute diligently the action on its own behalf; and

(*c*) the shareholder is acting in good faith and it is *prima facie* in the interests of the corporation or its shareholders that the action be commenced.

the court may make the order upon such terms as the court thinks fit, except that the order shall not require the shareholder to give security for costs.

Application for order for interim costs

(4) At any time or from time to time while an action commenced under this section is pending, the plaintiff may apply to the court for an order for

the payment to the plaintiff by the corporation of reasonable interim costs, including solicitor's and counsel fees and disbursements, for which interim costs the plaintiff shall be accountable to the corporation if the action is dismissed with costs on final disposition at the trial or on appeal.

Trial and judgment

(5) An action commenced under this section shall be tried by the court and its judgment or order in the cause, unless the action is dismissed with costs, may include a provision that the reasonable costs of the action are payable to the plaintiff by the corporation or other defendants taxed as between a solicitor and his own client.

Discontinuance and settlement

(6) An action commenced under this section shall not be discontinued, settled or dismissed for want of prosecution without the approval of the court and, if the court determines that the interests of the shareholders or any class thereof may be substantially affected by such discontinuance, settlement or dismissal, the court, in its discretion, may direct that notice in manner, form and content satisfactory to the court shall be given, at the expense of the corporation or any other party to the action as the court directs, to the shareholders or class thereof whose interests the court determines will be so affected.

Requisition for by-law or resolution

101.—(1) The persons holding equity shares carrying at least 10 per cent of the voting rights attached to all equity of shares of the corporation for the time being outstanding may requisition the directors to call a meeting of the directors for the purpose of passing any by-law or resolution that may properly be passed at a meeting of the directors duly called, constituted and held for that purpose.

Form of requisition

(2) The requisition shall set out the by-law or resolution, as the case may be, that is required to be passed at the meeting and shall be signed by the requisitionists and deposited at the head office of the corporations, and may consist of several documents in like form, each signed by one or more requisitionists.

Meeting of directors

(3) Upon deposit of the requisition, the directors shall forthwith call a meeting of the directors for the purpose of passing the by-law or resolution, as the case may be, set out in the requisition.

Meeting of shareholders

(4) Where the directors do not within twenty-one days from the date of the deposit of the requisition,

(*a*) call and hold such a meeting and pass such a by-law or resolution; and

(*b*) if the by-law or resolution requires confirmation at a general meeting of the shareholders, call a general meeting of the shareholders for the purpose of confirming the by-law or resolution,

any of the requisitionists may call a general meeting of the shareholders for the purpose of passing such by-law or resolution, and the meeting shall be held within sixty days from the date of the deposit of the requisition.

Notice

(5) A meeting of the shareholders called under subection (4) shall be called as nearly as possible in the same manner as meetings of shareholders are called under the by-laws, but, if the by-laws provide for more than twenty-one days notice of meetings, twenty-one days notice is sufficient for the calling of the meeting.

Validity of by-law or resolution

(6) Where a by-law or resolution is passed at a meeting of the shareholders called under subsection (4), either as set out in the requisition or as varied at the meeting, it is as valid and effective as if it had been passed at a meeting of the directors duly called, constituted and held for that purpose and confirmed at a meeting of the shareholders duly called, constituted and held for that purpose, and, if the resolution or by-law is passed by at least two-thirds of the votes cast at the meeting of the shareholders called under subsection (4), it shall be conclusively deemed to be a special resolution or special by-law, as the case may be, for the purposes of this Act.

Repayment of expenses

(7) The corporation shall,

(*a*) reimburse the requisitionists for any reasonable expenses incurred by them by reason of the failure of the directors to act in accordance with subsections (3) and (4); and

(*b*) retain out of any moneys due or to become due by way of fees or other remuneration for their services, to such of the directors as were in default, an amount equal to the amount the requisitionists were reimbursed.

unless, at the meeting called under subsection (4), the shareholders, by a majority of the votes cast, reject the reimbursement of the requisitionists.

New requisition on same subject

(8) Where a by-law or resolution in respect of which a meeting is required by requisition under this section is not passed at the meeting, no requisition for a meeting in respect of a similar by-law or resolution shall be made for a period of at least two years. *New.*

Circulation of shareholders' resolutions, etc.

102.—(1) On the requisition in writing of the persons holding equity shares carrying at least 5 per cent of the voting rights attached to all equity shares of the corporation for the time being outstanding, the directors shall,

(*a*) give to the shareholders entitled to notice of the next meeting of shareholders notice of any resolution that may properly be moved and is intended to be moved at that meeting; or

(*b*) circulate to the shareholders entitled to vote at the next meeting of shareholders a statement of not more than 1,000 words with respect to the matter referred to in any proposed resolution or with respect to the business to be dealt with at that meeting.

Notice

(2) The notice or statement or both, as the case may be, shall be given or circulated by sending a copy thereof to each shareholder entitled thereto in

the same manner and at the same time as that precribed by this Act, the articles or the by-laws, for the sending of notice of meetings of shareholders.

Idem

(3) Where it is not practicable to send the notice or statement or both at the same time as the notice of the meeting is sent, the notice or statement or both shall be sent as soon as practicable thereafter.

Deposit of requisition, etc.

(4) The directors are not bound under this section to give notice of any resolution or to circulate any statement unless,

- (*a*) the requisition, signed by the requisitionists, is deposited at the head office of the corporation,
  - (i) in the case of a requisition requiring notice of a resolution to be given, not less than twenty-one days before the meeting where the corporation is offering its securities to the public and not less than ten days before the meeting where the corporation is not offering its securities to the public,
  - (ii) in the case of a requisition requiring a statement to be circulated, not less than fourteen days before the meeting where the corporation is offering its shares to the public and not less than seven days before the meeting where the corporation is not offering its shares to the public; and
- (*b*) there is deposited with the requisition a sum reasonably sufficient to meet the expenses of the corporation in giving effect thereto.

Where directors not bound to circulate statement

(5) The directors are not bound under this section to circulate any statement if, on the application of the corporation or any other person who claims to be aggrieved, the court is satisfied that the rights conferred by this section are being abused to secure needless publicity for defamatory matter, and on any such application the court may order the costs of the corporation to be paid in whole or in part by

the requisitionists notwithstanding that they are not parties to the application.

Where no liability

(6) No corporation or a director, officer or employee thereof or person acting on its behalf, except a requisitionist, is liable in damages or otherwise by reason only of the giving of a notice or the circulation of a statement, or both, in compliance with this section.

Duty to deal with requisitioned matter

(7) Notwithstanding anything in the by-laws of the corporation, where the requisitionists have complied with this section, the resolution, if any, mentioned in the requisition shall be dealt with at the meeting to which the requisition relates.

Repayment of expenses

(8) The corporation shall pay to the requisitionists the sum deposited under clause (*b*) of subsection (4) unless at the meeting to which the requisition relates the shareholders by a majority of the votes cast reject the repayment to the requisitionists. R.S.O. 1960, c. 71, s. 309 (1)-(8), *amended.*

Requisition for shareholders' meeting

109.—(1) The persons holding equity shares carrying at least 5 per cent of the voting rights attached to all equity shares of the corporation for the time being outstanding may requisition the directors to call a general meeting of the shareholders for any purpose that is connected with the affairs of the corporation and that is not inconsistent with this Act.

Requisition

(2) The requisition shall state the general nature of the business to be presented at the meeting and shall be signed by the requisitionists and deposited at the head office of the corporation and may consist of several documents in like form, each signed by one or more requisitionists.

Duty of directors to call meeting

(3) Upon deposit of the requisition, the directors shall forthwith call a general meeting of the shareholders for the transaction of the business stated in the requisition.

Where requisitionists may call meeting

(4) If the directors do not within thirty days from the date of the deposit of the requisition call and hold the meeting, any of the requisitionists may call the meeting, which shall be held within sixty days from the date of the deposit of the requisition.

Calling of meeting

(5) A meeting called under this section shall be called as nearly as possible in the same manner as meetings of shareholders are called under the by-laws, but, if the by-laws provide for more than twenty-one days notice of meetings, twenty-one days notice is sufficient for the calling of the meeting.

Repayment of expenses

(6) The corporation shall,

(*a*) reimburse the requisitionists for any reasonable expenses incurred by them by by reason of the action taken by them under subsection (4); and

(*b*) retain out of any moneys due or to become due, by way of fees or other remuneration for their services, to such of the directors as were in default, an amount equal to the amount the requisitionists were reimbursed.

unless, at the meeting, the shareholders by a majority of the votes cast reject the reimbursement of the requisitionists. R.S.O. 1960, c. 71, s. 308, *amended.*

Idem, on court order

110. Notwithstanding section 109, upon application by a shareholder of a corporation, the court, if satisfied that the application is made in good faith and that it is *prima facie* in the interests of the corporation or its shareholders that the meeting be held on requisition, may make an order, upon such terms as to security for the costs of holding the meeting or otherwise as to the court seem fit, requiring the directors to call a general meeting of the shareholders for any purpose that is connected with the affairs of the corporation and that is not inconsistent with this Act. *New.*

APPENDIX D

Partial list of persons and organizations who submitted written briefs, communications or suggestions.

Dr. B. N. Arnason

Don Mills Consumers Co-operative

Federation of Co-operative Milk Transports

Heathhaven Apartments Limited

Institute of Chartered Accountants of Ontario

New Dundee Co-operative Creamery Limited

Ontario Co-operative Development Association

United Co-operatives of Ontario

United Dairy Producers Co-operatives Limited

G. H. Ward and Partners

APPENDIX G

Participants, other than those listed in Appendix F, who submitted briefs, comments and suggestions

Dr. B. N. Arnason

Don Mills Consumer Co-operative

Federation of Co-operative Milk Transports

Heathhaven Apartments Limited

Institute of Chartered Accountants of Ontario

New Dundee Co-operative Creamery Limited

Ontario Co-operative Development Association

United Co-operatives of Ontario

United Dairy Producers Co-operative Limited

G. H. Ward and Partners